
**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 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 March 31, 2005

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes No

Number of shares outstanding of each of the issuer's classes of common stock, as of April 30, 2005:

Common Stock, \$0.01 par value, 21,891,272 shares outstanding

PS BUSINESS PARKS, INC.

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PS BUSINESS PARKS, INC.
CONSOLIDATED BALANCE SHEETS
(In thousands, except share amounts)

	March 31, 2005	December 31,
	(Unaudited)	2004
ASSETS		
Cash and cash equivalents	\$ 61,661	\$ 39,688
Real estate facilities, at cost:		
Land	382,908	382,908
Buildings and equipment	<u>1,197,006</u>	<u>1,187,584</u>
	1,579,914	1,570,492
Accumulated depreciation	<u>(314,470)</u>	<u>(295,415)</u>
	1,265,444	1,275,077
Property held for disposition, net.....	6,128	16,876
Land held for development.....	<u>10,163</u>	<u>11,583</u>
	1,281,735	1,303,536
Rent receivable	3,041	2,079
Deferred rent receivables	16,533	15,470
Other assets.....	<u>2,558</u>	<u>3,056</u>
Total assets	<u>\$ 1,365,528</u>	<u>\$ 1,363,829</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Accrued and other liabilities	\$ 37,326	\$ 38,453
Mortgage notes payable.....	<u>11,265</u>	<u>11,367</u>
Total liabilities	48,591	49,820
Minority interests:		
Preferred units.....	127,750	127,750
Common units.....	169,728	169,295
Commitments and Contingencies		
Shareholders' equity:		
Preferred stock, \$0.01 par value, 50,000,000 shares authorized, 20,434 shares issued and outstanding at March 31, 2005 and December 31, 2004.....	510,850	510,850
Common stock, \$0.01 par value, 100,000,000 shares authorized, 21,891,272 and 21,839,667 shares issued and outstanding at March 31, 2005 and December 31, 2004, respectively.....	219	218
Paid-in capital	421,863	420,351
Cumulative net income	360,622	343,529
Cumulative distributions.....	<u>(274,095)</u>	<u>(257,984)</u>
Total shareholders' equity	<u>1,019,459</u>	<u>1,016,964</u>
Total liabilities and shareholders' equity	<u>\$ 1,365,528</u>	<u>\$ 1,363,829</u>

See accompanying notes.

PS BUSINESS PARKS, INC.
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited, in thousands, except share amounts)

	<u>March 31, 2005</u>	<u>March 31, 2004</u>
Revenues:		
Rental income	\$ 55,741	\$ 53,610
Facility management fees primarily from affiliates	<u>145</u>	<u>155</u>
Total operating revenues.....	<u>55,886</u>	<u>53,765</u>
Expenses:		
Cost of operations.....	16,388	16,116
Depreciation and amortization.....	19,016	17,404
General and administrative	<u>1,438</u>	<u>1,091</u>
Total operating expenses	<u>36,842</u>	<u>34,611</u>
Other income and expenses:		
Gain on sale of marketable securities	—	—
Interest and other income.....	398	27
Interest expense	<u>(282)</u>	<u>(1,266)</u>
Total other income and expenses.....	<u>116</u>	<u>(1,239)</u>
Income from continuing operations before minority interests.....	<u>19,160</u>	<u>17,915</u>
Minority interests in continuing operations:		
Minority interest in income — preferred units		
Distributions paid to preferred unit holders	(2,691)	(4,810)
Redemption of preferred operating partnership units	—	(267)
Minority interest in income — common units.....	<u>(1,682)</u>	<u>(1,267)</u>
Total minority interests in continuing operations	<u>(4,373)</u>	<u>(6,344)</u>
Income from continuing operations.....	<u>14,787</u>	<u>11,571</u>
Discontinued operations:		
Income from discontinued operations.....	165	550
Gain on disposition of real estate.....	2,914	—
Minority interest in earnings attributable to discontinued operations — common units.....	<u>(773)</u>	<u>(138)</u>
Income from discontinued operations.....	<u>2,306</u>	<u>412</u>
Net income.....	<u>17,093</u>	<u>11,983</u>
Net income allocable to preferred shareholders:		
Preferred distributions		
Preferred distributions paid.....	9,769	5,959
Redemption of preferred stock	—	1,866
Total preferred distributions	<u>9,769</u>	<u>7,825</u>
Net income allocable to common shareholders	<u>\$ 7,324</u>	<u>\$ 4,158</u>
Net income per common share — basic:		
Continuing operations.....	\$ 0.23	\$ 0.17
Discontinued operations	\$ 0.11	\$ 0.02
Net income.....	\$ 0.34	\$ 0.19
Net income per common share — diluted:		
Continuing operations.....	\$ 0.23	\$ 0.17
Discontinued operations	\$ 0.10	\$ 0.02
Net income.....	\$ 0.33	\$ 0.19
Weighted average common shares outstanding:		
Basic	<u>21,852</u>	<u>21,613</u>
Diluted	<u>22,012</u>	<u>21,778</u>

See accompanying notes.

PS BUSINESS PARKS, INC.
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
FOR THE THREE MONTHS ENDED MARCH 31, 2005
(Unaudited, in thousands, except share data)

	<u>Preferred Stock</u>		<u>Common Stock</u>		<u>Paid-in Capital</u>	<u>Cumulative Net Income</u>	<u>Cumulative Distributions</u>	<u>Total Shareholders' Equity</u>
	<u>Shares</u>	<u>Amount</u>	<u>Shares</u>	<u>Amount</u>				
Balances at December 31, 2004	20,434	\$ 510,850	21,839,667	\$ 218	\$ 420,351	\$ 343,529	\$ (257,984)	\$ 1,016,964
Exercise of stock options	—	—	46,696	1	1,245	—	—	1,246
Stock compensation	—	—	4,909	—	364	—	—	364
Net income	—	—	—	—	—	17,093	—	17,093
Distributions paid:								
Preferred stock.....	—	—	—	—	—	—	(9,769)	(9,769)
Common stock.....	—	—	—	—	—	—	(6,342)	(6,342)
Adjustment to minority interest's underlying ownership	—	—	—	—	(97)	—	—	(97)
Balances at March 31, 2005.....	<u>20,434</u>	<u>\$ 510,850</u>	<u>21,891,272</u>	<u>\$ 219</u>	<u>\$ 421,863</u>	<u>\$ 360,622</u>	<u>\$ (274,095)</u>	<u>\$ 1,019,459</u>

See accompanying notes.

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

	<u>For the Three Months</u> <u>Ended March 31,</u>	
	<u>2005</u>	<u>2004</u>
Cash flows from operating activities:		
Net income.....	\$ 17,093	\$ 11,983
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization expense.....	19,016	17,884
In-place rents adjustment.....	39	39
Minority interest in income	5,146	6,482
Gain on disposition of properties.....	(2,914)	—
Stock compensation expense	127	322
Increase in receivables and other assets.....	(1,210)	(2,357)
Increase (decrease) in accrued and other liabilities	(744)	1,479
Total adjustments.....	<u>19,460</u>	<u>23,849</u>
Net cash provided by operating activities	<u>36,553</u>	<u>35,832</u>
Cash flows from investing activities:		
Capital improvements to real estate facilities	(9,628)	(6,126)
Proceeds from disposition of real estate facilities.....	<u>15,267</u>	—
Net cash provided by (used in) investing activities	<u>5,639</u>	<u>(6,126)</u>
Cash flows from financing activities:		
Borrowings on credit facility	—	61,000
Repayment of borrowings on credit facility	—	(95,000)
Repayment of borrowings from an affiliate.....	—	(100,000)
Principal payments on mortgage notes payable.....	(102)	(154)
Repayment of unsecured note payable	—	(50,000)
Net proceeds from the issuance of preferred stock.....	—	166,841
Exercise of stock options.....	804	6,149
Shelf registration costs.....	—	(71)
Distributions paid to preferred shareholders.....	(9,769)	(5,959)
Distributions paid to minority interests – preferred units.....	(2,691)	(4,810)
Distributions paid to common shareholders	(6,342)	(6,278)
Distributions paid to minority interests – common units.....	<u>(2,119)</u>	<u>(2,119)</u>
Net cash used in financing activities.....	<u>(20,219)</u>	<u>(30,401)</u>
Net increase (decrease) in cash and cash equivalents.....	21,973	(695)
Cash and cash equivalents at the beginning of the period	39,688	5,809
Cash and cash equivalents at the end of the period.....	<u>\$ 61,661</u>	<u>\$ 5,114</u>
Supplemental schedule of non cash investing and financing activities:		
Unrealized loss:		
Comprehensive (income) on interest rate swap.....	\$ —	\$ (212)
Other comprehensive income (loss)	\$ —	\$ 212
Adjustment to reflect minority interest to underlying ownership interest:		
Minority interest – common units.....	\$ 97	\$ (230)
Paid-in capital	\$ (97)	\$ 230
Effect of EITF Topic D-42:		
Cumulative distributions.....	\$ —	\$ (1,866)
Minority interest – common units.....	\$ —	\$ (267)
Paid-in capital.....	\$ —	\$ 2,133

See accompanying notes.

PS BUSINESS PARKS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2005

1. Organization and description of business

PS Business Parks, Inc. ("PSB") was incorporated in the state of California in 1990. As of March 31, 2005, PSB owned approximately 75% of the common partnership units of PS Business Parks, L.P. (the "Operating Partnership" or "OP"). The remaining common partnership units were owned by Public Storage, Inc. ("PSI") and its affiliates. 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 March 31, 2005, the Company owned and operated approximately 17.9 million net rentable square feet of commercial space located in eight states. The Company also manages approximately 1.2 million net rentable square feet on behalf of PSI and its affiliated entities.

2. Summary of significant accounting policies

Basis of presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles 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 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 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 months ended March 31, 2005 are not necessarily indicative of the results that may be expected for the year ended December 31, 2005. 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, 2004.

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

Use of estimates

The preparation of the 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 consolidated financial statements and accompanying notes. Actual results could differ from estimates.

Allowance for doubtful accounts

We monitor the collectibility of our receivable balances, including the deferred rent receivable, on an on-going basis. Based on these reviews, we maintain an allowance for doubtful accounts for estimated losses resulting from the possible inability of our tenants to make required rent payments to us. A provision for doubtful accounts is recorded during each period. The allowance for doubtful accounts, which represents the cumulative allowances less write-offs of uncollectible rent, is netted against tenant and other receivables on our consolidated

balance sheets. Tenant receivables are net of an allowance for uncollectible accounts totaling \$550,000 at March 31, 2005.

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 judgement 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.

Financial assets that are exposed to credit risk consist primarily of cash and cash equivalents and receivables. Cash and cash equivalents, which consist primarily of short-term investments, including commercial paper, are only invested in entities with an investment grade rating. Receivables are comprised of balances due from a large number of tenants. Balances that the Company expects to become uncollectable are reserved for or written off.

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. Expenditures that are expected to benefit a period greater than 24 months and exceed \$2,000 are capitalized and depreciated over the estimated useful life. Buildings and equipment are depreciated on the straight-line method over the estimated useful lives, which are generally 30 and 5 years, respectively. Leasing costs in excess of \$1,000 for leases with terms greater than two years are capitalized and depreciated/amortized over their estimated useful lives. Leasing costs for leases of less than two years or less than \$1,000 are expensed as incurred.

Properties held for disposition

The Company accounts for properties held for disposition in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". An asset is classified as an asset held for disposition when it meets the requirements of SFAS No. 144, which include, among other criteria, the approval of the sale of the asset, the asset has been marketed for sale and the Company expects that the sale will likely occur within the next twelve months. Upon classification of an asset as held for disposition, the net book value of the asset, net of any impairment provision and estimated costs of disposition, is included on the balance sheet as assets held for distribution and the operating results of the asset are included in discontinued operations.

Intangible assets

Intangible assets consist of property management contracts for properties managed, but not owned, by the Company. The intangible assets were amortized over seven years. At March 31, 2005 intangible assets were fully amortized.

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. In addition, the Company evaluates its

assets held for disposition. Assets held for disposition are reported at the lower of their carrying amount or fair value, less cost of disposition. At March 31, 2005, the Company did not consider any assets to be impaired.

Stock-based compensation

Prior to December 31, 2001, the Company elected to adopt the disclosure requirements of FAS 123 but continued to account for stock-based compensation under APB 25. Effective January 1, 2002, the Company adopted the Fair Value Method of accounting for stock options. As required by the transition requirements of FAS 123, amended by FAS 148, the Company will recognize compensation expense in the income statement using the Fair Value Method only with respect to stock options issued after January 1, 2002, but continue to disclose the pro-forma impact of utilizing the Fair Value Method on stock options issued prior to January 1, 2002. As a result, included in the Company's income statement for the quarters ended March 31, 2005 and 2004, is approximately \$92,000 and \$114,000, respectively, in stock option compensation expense related to options granted after January 1, 2002. See note 11.

The Company also recognizes compensation expense with regards to restricted stock units it grants. As a result included in the Company's income statement for the quarters ended March 31, 2005 and 2004, is approximately \$35,000 and \$208,000 respectively, in restricted stock expense.

Revenue and expense recognition

Revenue is recognized in accordance with Staff Accounting Bulletin No. 101 of the Securities and Exchange Commission, Revenue Recognition in Financial Statements (SAB 101), as amended. SAB 101 requires that four basic criteria must be met before revenue can be recognized: persuasive evidence of an arrangement exists; the delivery has occurred or services rendered; the fee is fixed and determinable; and collectibility is reasonably assured. All leases are classified as operating leases. Rental income is recognized on a straight-line basis over the terms of the leases. Straight-line rent is recognized for all tenants with contractual increases in rent that are not included on the Company's credit watch list. Deferred rent receivables represent rental revenue recognized on a straight-line basis in excess of billed rents. Reimbursements from tenants for real estate taxes and other recoverable operating expenses are recognized as revenues in the period the applicable costs are incurred. Property management fees are recognized in the period earned.

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

Gains/Losses from sales of real estate

The Company recognizes gains from sales of real estate at the time of sale using the full accrual method, provided that various criteria related to the terms of the transactions and any subsequent involvement by the Company with the properties sold are met. If the criteria are not met, the Company defers the gains and recognizes them when the criteria are met or using the installment or cost recovery methods as appropriate under the circumstances.

General and administrative expense

General and administrative expense includes executive and other compensation, office expense, professional fees, state income taxes, dues, listing fees and other administrative items.

Related party transactions

Pursuant to a cost sharing and administrative services agreement, the Company shares costs with PSI and affiliated entities for certain administrative services, which are allocated among PSI and its affiliates in accordance with a methodology intended to fairly allocate those costs. These costs totaled approximately \$85,000 and \$84,000 for the three months ended March 31, 2005 and 2004, respectively. In addition, the Company provides property management services for properties owned by PSI and its affiliates for a fee of 5% of the gross revenues of such properties in addition to reimbursement of direct costs. These management fee

revenues recognized under management contracts with affiliated parties totaled approximately \$145,000 and \$138,000 for the three months ended March 31, 2005 and 2004, respectively. In addition, through the first quarter of 2004, the Company combined its insurance purchasing power with PSI through a captive insurance company controlled by PSI, STOR-Re Mutual Insurance Corporation (“Stor-Re”). Stor-Re provided limited property and liability insurance to the Company at commercially competitive rates. The Company and PSI also utilized unaffiliated insurance carriers to provide property and liability insurance in excess of Stor-Re’s limitations.

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 organizational and operating requirements to maintain its REIT status during 2004 and intends to continue to meet such requirements for 2005. Accordingly, no provision for income taxes has been made in the accompanying consolidated financial statements.

Accounting for preferred equity issuance costs

In accordance with EITF Topic D-42, the Company records its issuance costs as a reduction to Paid-in Capital on its balance sheet at the time the preferred securities are issued and reflects the carrying value of the preferred stock at the stated value. The Company reduces the carrying value of preferred stock by the issuance costs at the time it notifies the holders of preferred stock or units of its intent to redeem such shares or units.

Net income per common share

Per share amounts are computed using the number of weighted average common shares outstanding. “Diluted” weighted average common shares outstanding includes the dilutive effect of stock options and restricted stock under the treasury stock method. “Basic” weighted average common shares outstanding excludes such effect. Earnings per share have been calculated as follows (unaudited, in thousands, except per share amounts):

	For the Three Months Ended March 31,	
	2005	2004
Net income allocable to common shareholders	<u>\$ 7,324</u>	<u>\$ 4,158</u>
Weighted average common shares outstanding:		
Basic weighted average common shares outstanding	21,852	21,613
Net effect of dilutive stock compensation — based on treasury stock method using average market price	<u>160</u>	<u>165</u>
Diluted weighted average common shares outstanding	<u>22,012</u>	<u>21,778</u>
Basic earnings per common share	<u>\$ 0.34</u>	<u>\$ 0.19</u>
Diluted earnings per common share	<u>\$ 0.33</u>	<u>\$ 0.19</u>

Options to purchase approximately 80,000 and 30,000 shares for the three months ended March 31, 2005 and 2004, respectively, were not included in the computation of diluted net income per share because such options were considered anti-dilutive.

Segment Reporting

The Company views its operations as one segment.

Reclassifications

Certain reclassifications have been made to the consolidated financial statements for 2004 in order to conform to the 2005 presentation.

3. Real estate facilities

The activity in real estate facilities for the three months ended March 31, 2005 is as follows (unaudited, in thousands):

	<u>Land</u>	<u>Buildings</u>	<u>Accumulated Depreciation</u>	<u>Total</u>
Balances at December 31, 2004.....	\$382,908	\$ 1,187,584	\$ (295,415)	\$ 1,275,077
Capital improvements, net	—	9,505	—	9,506
Disposition of real estate.....	—	(83)	—	(84)
In-place rent adjustment.....	—	—	(39)	(39)
Depreciation expense.....	—	—	(19,016)	(19,016)
Balances at March 31, 2005.....	<u>\$382,908</u>	<u>\$ 1,197,006</u>	<u>\$ (314,470)</u>	<u>\$ 1,265,444</u>

In the first quarter of 2005, the Company sold two assets previously classified as properties held for disposition. In February, 2005, the Company sold the 56,000 square foot retail center located at MICC for a sales price was approximately \$12.2 million resulting in a gain of \$967,000. In addition, in January, 2005, the Company closed on the sale of a 7,100 square foot unit at MICC for a gross sales price of \$740,000 resulting in a gain of \$142,000. On January 31, 2005, the Company closed on the sale of 8.2 acres of land within the Cornell Oaks project in Beaverton, Oregon for a sales price of approximately \$3.6 million resulting in a gain of \$1.8 million.

During the third quarter of 2004, the Company concluded that it would likely sell as many as 11 separate units, aggregating 90,000 square feet as well as a 56,000 square foot retail center of its Miami International Commerce Center in Miami, Florida. Accordingly, 9 of the 11 units remaining are classified as assets held for disposition at March 31, 2005. The operations of such are included in discontinued operations.

The following summarizes the condensed results of operations of the properties sold during 2005 and 2004 or held for disposition as of March 31, 2005, which are included in the consolidated statements of income as discontinued operations (unaudited, in thousands):

	<u>For the Three Months Ended March 31,</u>	
	<u>2005</u>	<u>2004</u>
Rental income.....	\$ 252	\$ 1,610
Cost of operations.....	(87)	(580)
Depreciation expense.....	—	(480)
Income from discontinued operations	<u>\$ 165</u>	<u>\$ 550</u>

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 March 31, 2005 under these leases are as follows (unaudited, in thousands):

2005	\$ 142,157
2006	150,326
2007	109,613
2008	77,928
2009	51,071
Thereafter.....	<u>98,121</u>
	<u>\$ 629,216</u>

In addition to minimum rental payments, tenants pay reimbursements for their pro rata share of specified operating expenses, which amounted to approximately \$6.6 million for the three months ended March 31, 2005 and 2004. These amounts are included as rental income and cost of operations in the accompanying consolidated statements of income.

Leases accounting for approximately 6% of leased square footage are subject to termination options as of March 31, 2005 which are exercisable now or at some future date. In general, these leases provide for termination payments should the termination options be exercised. The above table is prepared assuming such options are not exercised.

5. Bank Loans

The Company has a line of credit (the "Credit Facility") with Wells Fargo Bank with a borrowing limit of \$100.0 million and an expiration date of August 1, 2005. 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 0.60% to LIBOR plus 1.20% depending on the Company's credit ratings and coverage ratios, as defined (currently LIBOR plus 0.70%). In addition, the Company is required to pay an annual commitment fee ranging from 0.20% to 0.35% of the borrowing limit (currently 0.25%). The Company had no balance outstanding as of March 31, 2005 and December 31, 2004.

The Credit Facility requires the Company to meet certain covenants including (i) maintain a balance sheet leverage ratio (as defined) of less than 0.45 to 1.00, (ii) maintain interest and fixed charge coverage ratios (as defined) of not less than 2.25 to 1.00 and 1.75 to 1.00, respectively, (iii) maintain a minimum tangible net worth (as defined) and (iv) limit distributions to 95% of funds from operations (as defined) for any four consecutive quarters. 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 March 31, 2005.

In February 2002, the Company entered into a seven year \$50.0 million unsecured term note agreement with Fleet National Bank. The note bears interest at LIBOR plus 1.45% per annum and is due on February 20, 2009. The Company used the proceeds from the loan to reduce the amount drawn on the Credit Facility. During July 2002, the Company entered into an interest rate swap transaction which resulted in a fixed LIBOR rate through July 16, 2004 at 4.46% per annum. In February 2004, the Company repaid in full the \$50.0 million outstanding on the term loan.

6. Mortgage notes payable

	<u>March 31, 2005</u>	<u>December 31, 2004</u>
Mortgage notes consist of the following (unaudited, in thousands):		
8.19% mortgage note, principal and interest payable monthly, due March 2007	\$ 5,511	\$ 5,578
7.29% mortgage note, principal and interest payable monthly, due February 2009	<u>5,754</u>	<u>5,789</u>
	<u>\$ 11,265</u>	<u>\$ 11,367</u>

At March 31, 2005, approximate principal maturities of mortgage notes payable are as follows (unaudited, in thousands):

2005	\$ 318
2006	455
2007	5,169
2008	179
2009	<u>5,144</u>
	<u>\$ 11,265</u>

7. Minority interests

Common partnership 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 consolidated financial statements. Minority interest in income consists of the minority interests' share of the consolidated operating results.

Beginning one year from the date of admission as a limited partner (common units) 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 (common units) 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 applicable articles of incorporation, 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.

At March 31, 2005, there were 7,305,355 common units owned by PSI and affiliated entities, which are accounted for as minority interests. On a fully converted basis, assuming all 7,305,355 minority interest common units were converted into shares of common stock of PSB at March 31, 2005, the minority interest units would convert into approximately 25% of the common shares outstanding. Combined with PSI's common stock ownership, on a fully converted basis, PSI has a combined ownership of approximately 44% of the Company's common equity. At the end of each reporting period, the Company 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 interests' equity in the Company.

Preferred partnership units

Through the Operating Partnership, the Company has issued the following preferred units in separate private placement transactions (in thousands):

Series	Issuance Date	Earliest Redemption Date	Dividend Rate	March 31, 2005		December 31, 2004	
				Units Outstanding	Amount	Units Outstanding	Amount
Series Y	July 2000	July 2005	8.875%	480	\$ 12,000	480	\$ 12,000
Series E	September 2001	September 2006	9.250%	2,120	53,000	2,120	53,000
Series G	October 2002	October 2007	7.950%	800	20,000	800	20,000
Series J	May & June 2004	May 2009	7.500%	1,710	42,750	1,710	42,750
				<u>5,110</u>	<u>\$ 127,750</u>	<u>5,110</u>	<u>\$ 127,750</u>

On April 23, 2004 the Company redeemed 510,000 units of its 8.875% Series B Cumulative Redeemable Preferred Units for approximately \$12.8 million. In accordance with EITF D-42, the redemptions resulted in a reduction of net income allocable to common shareholders of approximately \$267,000 for the three months ended March 31, 2004, and a corresponding increase in the allocation of income to minority interests equal to the excess of the redemption amount over the carrying amount of the redeemed securities.

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 PSB 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 Cumulative Redeemable Preferred Stock will have the same distribution rate and par value as the corresponding preferred units and will otherwise have equivalent terms to the other series of preferred stock described in Note 9. As of March 31, 2005 the Company had approximately \$3.5 million of deferred costs in connection with the issuance of preferred units, which the Company will report as additional distributions upon notice of redemption.

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” names.

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 automatically extended one year on each anniversary. At any time, either party may notify the other that the contract is not to be extended, in which case the contract will expire on the first anniversary of its then scheduled expiration date. For PSI affiliate owned properties, PSI can cancel the property management contract upon 60 days notice while the Operating Partnership can cancel upon seven years notice. Management fee revenues under these contracts were \$145,000 and \$138,000 for the three months ended March 31, 2005 and 2004, respectively.

9. Shareholders' equity

Preferred stock

As of March 31, 2005 and December 31, 2004, the Company had the following series of preferred stock outstanding (in thousands, except shares outstanding amounts):

Series	Issuance Date	Earliest Redemption Date	Dividend Rate	March 31, 2005		December 31, 2004	
				Shares Outstanding	Amount	Shares Outstanding	Amount
Series D	May, 2001	May, 2006	9.500%	2,634	\$ 65,850	2,634	\$ 65,850
Series F	January, 2002	January, 2007	8.750%	2,000	50,000	2,000	50,000
Series H	January & October, 2004	January, 2009	7.000%	8,200	205,000	8,200	205,000
Series I	April, 2004	April, 2009	6.875%	3,000	75,000	3,000	75,000
Series K	June, 2004	June, 2009	7.950%	2,300	57,500	2,300	57,500
Series L	August, 2004	August, 2009	7.600%	2,300	57,500	2,300	57,500
				<u>20,434</u>	<u>\$ 510,850</u>	<u>20,434</u>	<u>\$ 510,850</u>

Holders of the Company's preferred stock are not 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.

Except under certain conditions relating to the Company's qualification as a REIT, the preferred stock is not redeemable prior to the previously noted redemption dates. On or after the respective redemption 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. As of March 31, 2005 the Company had approximately \$17.3 million of deferred costs in connection with the issuance of preferred stock, which the Company will report as additional non-cash distributions upon notice of its intent to redeem such shares.

Subsequent to March 31, 2005, the Company issued 3.3 million depositary shares each representing 1/1,000 of a share of the 7.200% Cumulative Preferred Stock, Series M, at a par value of \$25.00 per depositary share. The intended use of the proceeds from the offering will be to fund future preferred equity redemptions.

On April 30, 2004 the Company redeemed 2.1 million depositary shares of its 9.250% Cumulative Preferred Stock, Series A for approximately \$52.8 million. In accordance with EITF Topic D-42, the redemption resulted in a reduction of net income allocable to common shareholders of approximately \$1.9 million for the three months ended March 31, 2004 equal to the excess of the redemption amount over the carrying amount of the redeemed securities.

On January 30, 2004, the Company issued 6.9 million depositary shares, each representing 1/1,000 of a share of the Company's 7.000% Cumulative Preferred Stock, Series H, at \$25.00 per share. The Company received net proceeds of approximately \$166.8 million, which were used to repay outstanding short-term debt, consisting of borrowings under the Company's line of credit with Wells Fargo Bank and a portion of a short-term loan from Public Storage, Inc.

The Company recorded approximately \$9.8 million and \$7.8 million in distributions to its preferred shareholders for the three months ended March 31, 2005 and 2004, respectively. The distributions for the three months ended March 31, 2004 include approximately \$1.9 million of non-cash distributions related to EITF Topic D-42.

Common Stock

The Company's Board of Directors has authorized the repurchase, from time to time, of up to 4.5 million shares of the Company's common stock on the open market or in privately negotiated transactions. Since the inception of the program (March 2000), the Company has repurchased an aggregate total of 2.6 million shares of common stock and 30,484 units in its Operating Partnership at an aggregate cost of approximately \$70.7 million (average cost of \$26.66 per share/unit). No shares were repurchased in 2004 or 2005.

The Company paid approximately \$6.3 million (\$0.29 per common share) in distributions to its common shareholders for the three months ended March 31, 2005 and 2004. Pursuant to restrictions imposed by the Credit Facility, distributions may not exceed 95% of funds from operations, as defined.

Equity stock

In addition to common and preferred stock, the Company is authorized to issue 100.0 million 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 give 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. Commitments and Contingencies

The Company currently is neither subject to any 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.

11. Stock-Based Compensation

PSB has a 1997 Stock Option and Incentive Plan (the "1997 Plan") and a 2003 Stock Option and Incentive Plan (the "2003 Plan"), each covering 1.5 million shares of PSB's common stock. Under the 1997 Plan and 2003 Plan, PSB has granted non-qualified options to certain directors, officers and key employees to purchase shares of PSB's common stock at a price no less than the fair market value of the common stock at the date of grant.

Through December 31, 2001, the Company elected to adopt the disclosure requirements of FAS 123 but continue to account for stock-based compensation under APB 25. Effective January 1, 2002, the Company adopted the Fair Value Method of accounting for stock options. As required by the transition requirements of FAS 123, as amended by FAS 148, the Company will recognize compensation expense in the income statement using the Fair Value Method only with respect to stock options issued after January 1, 2002, but continue to disclose the pro-forma impact of utilizing the Fair Value Method on stock options issued prior to January 1, 2002. As a result, included in the Company's income statement for the three months ended March 31, 2005 and 2004 is approximately \$92,000 and \$114,000, respectively, in stock option compensation expense related to options granted after January 1, 2002.

The weighted average grant date fair value of the options for the three months ended March 31, 2004 was \$5.90, per share. The Company did not grant any options during the three months ended March 31, 2005. Had compensation cost for the 1997 Plan for options granted prior to December 31, 2001 been determined based on the fair value at the grant date for awards under the Plan consistent with the method prescribed by SFAS No. 123, the Company's pro forma net income available to common shareholders would have been as follows (in thousands, except per share amounts):

	For the three months ended	
	March 31,	
	<u>2005</u>	<u>2004</u>
Net income allocable to common shareholders, as reported.....	\$ 7,324	\$ 4,158
Deduct: Total stock-based employee compensation expense determined under fair value based method of all awards	<u>—</u>	<u>84</u>
Net income allocable to common shareholders, as adjusted.....	<u>\$ 7,324</u>	<u>\$ 4,074</u>
Earnings per share:		
Basic as reported.....	<u>\$ 0.34</u>	<u>\$ 0.19</u>
Basic as adjusted.....	<u>\$ 0.34</u>	<u>\$ 0.19</u>
Diluted as reported	<u>\$ 0.33</u>	<u>\$ 0.19</u>
Diluted as adjusted	<u>\$ 0.33</u>	<u>\$ 0.19</u>

For these disclosure purposes, the fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions used for grants during the three months ended March 31, 2004: a dividend yield of 2.6%; expected volatility of 17.0%; expected life of five years; and a risk-free interest rate of 2.74%. The pro forma effect on net income allocable to common shareholders during the three months ended March 31, 2004, may not be representative of the pro forma effect on net income allocable to common shareholders in future years.

During the three months ended March 31, 2005, 46,696 stock options were exercised for approximately \$1.2 million.

The Company has granted 196,250 restricted stock units under the 1997 Plan and 2003 Plan since inception. As of March 31, 2005 103,700 restricted stock units were outstanding. The restricted stock units were granted at a zero exercise price. The fair market value of the restricted stock units at the date of grant ranged from \$24.02 to \$45.51 per restricted stock unit. The restricted stock units granted prior to August, 2002 (88,000 units) are subject to a five-year vesting schedule, with 30% of the units vesting in year three, 30% in year four and 40% in year five. Restricted stock units granted subsequent to August, 2002 (108,250 units) are subject to a six year vesting schedule, with none of the units vesting in year one and 20% of the units vesting in each of the next five years. Compensation expense of \$35,000 and \$208,000 related to these units was recognized during the three months ended March 31, 2005 and 2004, respectively. During the three months ended March 31, 2005, 8,050 restricted stock units vested; of this amount, 4,909 shares were issued, net of shares applied to payroll taxes.

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 "may," "believes," "anticipates," "plans," "expects," "seeks," "estimates," "intends," 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

The Company owns and operates approximately 17.9 million rentable square feet of flex, industrial and office properties located in eight states.

The Company focuses on increasing profitability and cash flow aimed at maximizing shareholder value. The Company strives to maintain high occupancy levels while increasing rental rates when market conditions allow. The Company also acquires properties which it believes will create long-term value, and disposes of properties which no longer fit within the Company's strategic objectives or in situations where it can optimize cash proceeds. Operating results are driven by income from rental operations and are therefore substantially influenced by rental demand for space within our properties.

In 2004, the Company continued to experience the effects of a generally slow economy and a particularly difficult real estate market heavily favoring tenants. These market conditions impacted many aspects of the Company's business including occupancy levels, rental rates and transaction costs. Market conditions, characterized by weak demand and over supply, resulted in downward pressure on rental rates coupled with increased necessity to give rental concessions in the form of free rent. In addition, the Company continued to experience increasing tenant improvement costs during 2004. During 2005, some of the Company's stronger markets, such as Southern California and Washington Metro may experience upward trends in rental rates, coupled with reduced rent concessions and tenant improvement costs. These conditions could be offset by markets such as Portland, Austin, and Dallas, which have experienced decreases in occupancies and rental rates and increases in capital expenditures. See further discussion of operating results below.

Critical Accounting Policies and Estimates:

Our significant accounting policies are described in Note 2 to the consolidated financial statements included in this Form 10-Q. We believe our most critical accounting policies relate to revenue recognition, allowance for doubtful accounts, impairment of long-lived assets, depreciation, accruals of operating expenses and accruals for contingencies, each of which we discuss below.

Revenue Recognition: We recognize revenue in accordance with Staff Accounting Bulletin No. 101 of the Securities and Exchange Commission, Revenue Recognition in Financial Statements (SAB 101), as amended. SAB 101 requires that the following four basic criteria must be met before revenue can be recognized: persuasive evidence of an arrangement exists; the delivery has occurred or services rendered; the fee is fixed and determinable; and collectibility is reasonably assured. All leases are classified as operating leases. Rental income is recognized on a straight-line basis over the terms of the leases. Straight-line rent is recognized for all tenants with contractual increases in rent that are not included on the Company's credit watch list. Deferred rent receivables represent rental revenue recognized on a straight-line basis in excess of billed rents. Reimbursements from tenants for real estate taxes and other recoverable operating expenses are recognized as revenues in the period the applicable costs are incurred.

Allowance for Doubtful Accounts: Rental revenue from our tenants is our principal source of revenue. We monitor the collectibility of our receivable balances including the deferred rent receivable on an on-going basis. Based on these reviews, we maintain an allowance for doubtful accounts for estimated losses resulting from the possible inability of our tenants to make required rent payments to us. Tenant receivables and deferred rent receivables are carried net of the allowances for uncollectible tenant receivables and deferred rent. As discussed below, management's determination of the adequacy of these allowances requires significant judgments and estimates. Management's estimate of the required allowance is subject to revision as the factors discussed below change and is sensitive to the effect of economic and market conditions on our tenants.

Tenant receivables consist primarily of amounts due for contractual lease payments, reimbursements of common area maintenance expenses, property taxes and other expenses recoverable from tenants. Management's determination of the adequacy of the allowance for uncollectible current tenant receivables is performed using a methodology that incorporates specific identification, aging analysis, an overall evaluation of the Company's historical loss trends and the current economic and business environment. The specific identification methodology relies on factors such as the age and nature of the receivables, the payment history and financial condition of the tenant, the Company's assessment of the tenant's ability to meet its lease obligations, and the status of negotiations of any disputes with the tenant. The Company's allowance also includes a reserve based on historical loss trends not associated with any specific tenant. This reserve as well as the Company's specific identification reserve is reevaluated quarterly based on economic conditions and the current business environment.

Deferred rents receivable represents the amount that the cumulative straight-line rental income recorded to date exceeds cash rents billed to date under the lease agreement. Given the longer-term nature of these types of receivables, management's determination of the adequacy of the allowance for unbilled deferred rents receivables is based primarily on historical loss experience. Management evaluates the allowance for unbilled deferred rents receivable using a specific identification methodology for the Company's significant tenants designed to assess the tenants' financial condition and their ability to meet their lease obligations.

Impairment of Long-Lived Assets: The Company evaluates a property for potential impairment whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. On a quarterly basis, the Company evaluates the whole portfolio for impairment based on current operating information. In the event that these periodic assessments reflect that the carrying amount of a property exceeds the sum of the undiscounted cash flows (excluding interest) that are expected to result from the use and eventual disposition of the property, the Company would recognize an impairment loss to the extent the carrying amount exceeded the estimated fair value of the property. The estimation of expected future net cash flows is inherently uncertain and relies on subjective assumptions dependent upon future and current market conditions and events that affect the ultimate value of the property. It requires management to make assumptions related to the property such as future rental rates, tenant allowances, operating expenditures, property taxes, capital improvements, occupancy levels, and the estimated proceeds generated from the future sale of the property. These assumptions could differ materially from actual results in future periods. Since Statement of Financial Accounting Standards ("SFAS") No. 144 provides that the future cash flows used in this analysis be considered on an undiscounted basis, our historically established intent to hold properties over the long term directly decreases the likelihood of recording an impairment loss. If our strategy changes or if market conditions otherwise dictate an earlier sale date, an impairment loss could be recognized and such loss could be material.

Depreciation: We compute depreciation on our buildings and equipment using the straight-line method based on estimated useful lives of generally 30 and 5 years. A significant portion of the acquisition cost of each property is allocated to building and building components (usually 75-85%). The allocation of the acquisition cost to building and building components, as well as, the determination of their useful lives are based on management's estimates. If we do not appropriately allocate to these components or we incorrectly estimate the useful lives of these components, our computation of depreciation expense may not appropriately reflect the actual impact of these costs over future periods, which will affect net income. In addition, the net book value of real estate assets could be over or understated. The statement of cash flows, however, would not be affected.

Accruals of Operating Expenses: The Company accrues for property tax expenses, performance bonuses and other operating expenses each quarter based on historical trends and anticipated disbursements. If these estimates are incorrect, the timing of expense recognition will be affected.

Accruals for Contingencies: The Company is exposed to business and legal liability risks with respect to events that may have occurred, but in accordance with generally accepted accounting principles has not accrued for such potential liabilities because the loss is either not probable or not estimable. Future events and the result of pending litigation could result in such potential losses becoming probable and estimable, which could have a material adverse impact on our financial condition or results of operations.

Effect of Economic Conditions on the Company's Operations: During 2003 and 2004, the Company had been affected by the slowdown in economic activity in certain markets. These effects include a decline in occupancy rates, a reduction in market rental rates, increased rent concessions, tenant improvement allowances and lease commissions, slower than expected lease-up of the Company's newly acquired properties, increased tenant defaults and the termination of leases pursuant to early termination options. In 2005, the Company anticipates that certain conditions in these challenged markets, such as occupancy and capitalized leasing costs may stabilize. Properties in the Company's healthier markets may experience sustained or nominal rental rate increases as well as increased occupancy.

The reduction in occupancies and market rental rates in these challenged markets has been the result of several factors related to general economic conditions. There are more businesses contracting than expanding, more businesses failing than starting-up and general uncertainty for businesses, resulting in slower decision-making and requests for shorter-term leases. There is also more competing vacant space, including substantial amounts of sub-lease space, in many of the Company's challenged markets. Many of the Company's properties have lower vacancy rates than the average rates for the markets in which they are located; consequently, the Company may have difficulty in maintaining its occupancy rates as leases expire.

The Company has a lease with Footstar that generates less than 1% of our revenues. Footstar and its affiliates filed for protection under Chapter 11 of the U.S. Bankruptcy Laws in 2004. In connection with such filing, they immediately rejected one of two leases with the Company. The rejected lease consisted of approximately 60,000 square feet in Dallas, Texas, with annual rents of approximately \$620,000. The court has not approved Footstar's petition to reject the remaining lease. The Company has taken back approximately 13,400 square feet of the original 57,000 square foot lease in order to execute a lease with another tenant. The remaining Footstar lease generates annual rents of approximately \$740,000. In September 2004, the Company restructured a 134,000 square foot lease with a previous top ten tenant in Northern California that reset the term to 10 years and reduced the initial monthly rents by approximately \$120,000 per month, with annual increases thereafter. Additionally, a tenant occupying approximately 91,000 square feet in Northern California, with annual rents of approximately \$600,000, filed for protection under Chapter 11 of the U.S. Bankruptcy Laws on April 12, 2005. On April 19, 2005 the petition to reject the Company's lease was accepted by the court. The tenant vacated prior to filing the petition, which has allowed the Company to actively market the space. Several other tenants have contacted us, requesting early termination of their lease, reduction in space under lease, rent deferment or abatement. At this time, the Company cannot anticipate what impact, if any, the ultimate outcome of these discussions will have on our operating results.

Effect of Economic Conditions on the Company's Primary Markets: The Company has concentrated its operations in nine markets. Each of these markets has been affected by the slowdown in economic activity in some way. The Company's overall view of these markets as of March 31, 2005, is summarized below. Overall, during the three months ended March 31, 2005, the Company has seen rental rates on new leases and renewed leases within its portfolio decrease by an average of 1.6% from the most recent in place rents prior to renewal or replacement. The Company has compiled the market occupancy information set forth below using third party reports for these respective markets. These sources are deemed to be reliable by the Company, but there can be no assurance that these reports are accurate.

The Company owns approximately 3.7 million square feet in Southern California. This is one of the more stable markets in the country but continues to experience relatively flat, or modestly increasing, rental rates. Vacancy rates have decreased slightly throughout Southern California for flex, industrial and office space, and range from 10.4%

to 14.2% for office and less than 4% for industrial, depending on submarkets and product type. The Company's vacancy rate at March 31, 2005 was approximately 5.1%.

The Company owns approximately 2.8 million square feet in Northern Virginia, where the overall market vacancy rate was 10.7% as of March 31, 2005. Suburban Washington D.C. submarkets have continued to be positively impacted by increased federal government spending on defense and national security. The Company's vacancy rate at March 31, 2005 was 4.9%.

The Company owns approximately 1.2 million square feet in Maryland. The portfolio is primarily located in the Montgomery County submarket which remains stable, with signs of some increase in rental rates. The Company expects the business of the federal government, defense contractors and the biotech industry will likely remain strong in 2005. The Company's vacancy rate at March 31, 2005 was 4.9%.

The Company owns approximately 1.5 million square feet in Northern California with a concentration in South San Francisco, Sacramento, Santa Clara and North San Jose submarkets of Silicon Valley. The vacancy rates in these submarkets stand at 20%, 14% and 21%, respectively. The Company's vacancy rate at March 31, 2005 was 5.2%.

The Company owns approximately 1.9 million square feet in the Beaverton submarket of Portland, Oregon. Leasing activity slowed dramatically in 2003 and continued to slow through the first half of 2004. While market conditions have not changed dramatically, the Company has noticed an increase in leasing activity within the market in 2005. The vacancy rate in this market is over 21%. On the supply side, it is unlikely that significant new construction starts will occur during 2005 as a lack of demand and availability has had a negative impact on market rental rates. The Company's vacancy rate at March 31, 2005 was 19.2%.

The Company owns approximately 1.7 million square feet in the Dallas Metroplex market. The vacancy rate in Las Colinas, where most of the Company's properties are located, is nearing 21% for office and 12% for industrial flex. Over the last two years, the number of new properties coming on-line decreased. The Company believes that any new construction could cause vacancy rates to rise and limit opportunities to increase rental rates. The Company's vacancy rate at December 31, 2004 was 13.7%.

The Company owns approximately 1.2 million square feet in the Austin and greater Houston markets. The Austin market has been adversely affected by downturns in the technology industry. Softness in this market has increased competition for tenants, resulting in a reduction in rental rates and increased rent concessions, tenant improvement allowances and lease commissions. The Company's vacancy rate at March 31, 2005 was 18.2%, which was roughly equivalent to market averages.

In December, 2003, the Company acquired a 3.3 million square foot property located in the Airport West submarket of Miami-Dade County in Florida. The property's vacancy rate upon acquisition was approximately 16.6%, compared to a vacancy rate of approximately 11.1% for the entire submarket. The property is located less than one mile from the cargo entrance of the Miami International Airport, which is recognized as one of the nation's busiest cargo and passenger airports. The Company's vacancy rate at March 31, 2005 was 10.8%, compared to 10.9% for the submarket.

The Company owns approximately 679,000 square feet in the Phoenix market. Overall, the Phoenix market has been characterized by steady growth. The vacancy rate in this market is over 8%. The Company's vacancy rate at March 31, 2005 was 6.0% .

Growth of the Company's Operations and Acquisitions and Dispositions of Properties : During 2005, the Company is focused on maximizing cash flow from its existing portfolio of properties and through acquisitions and dispositions of properties, expanding its presence in existing and new markets through strategic acquisitions and strengthening its balance sheet, primarily through the issuance of preferred equity. The Company has historically maintained low debt and overall leverage levels through the issuance of preferred equity; this approach is intended to provide the Company with the flexibility for future growth needed to issue additional common stock.

In 2004, the Company acquired a 165,000 square foot office complex in Fairfax, Virginia, for \$24.1 million. Also, in 2004 the Company sold a flex facility in Austin, Texas, for approximately \$1.2 million, a 30,500 square foot building in Beaverton, Oregon for \$3.1 million, two units at MICC totaling approximately 17,000 square feet for gross proceeds of \$1.9 million and two flex parks totaling approximately 400,000 square feet in Maryland for approximately \$44.2 million. In connection with these sales, the Company reported an aggregate gain of \$15.5 million.

In February, 2005, the Company sold the 56,000 square foot retail center located at MICC for a sales price of approximately \$12.2 million. In addition, in January, 2005, the Company closed on the sale of a 7,100 square foot unit at MICC for a sales price of \$740,000 and closed on the sale of 8.2 acres of land within the Cornell Oaks project in Beaverton, Oregon for a sales price of approximately \$3.6 million. The Company reported a combined gain of \$2.9 million on the sale of these three assets.

During the third quarter of 2004 the Company concluded that it would likely proceed with the sale of certain assets. Accordingly, such assets have been classified as assets held for disposition and the operations of such assets have been reflected as discontinued operations. Included in assets held for sale at March 31, 2005 are 9 units, aggregating approximately 76,000 square feet at Miami International Commerce Center ("MICC").

Impact of Inflation: Although inflation has slowed in recent years, it is still a factor in our economy and the Company continues to seek ways to mitigate its impact. A substantial portion of the Company's leases require tenants to pay operating expenses, including real estate taxes, utilities, and insurance, as well as increases in common area expenses. Management believes these provisions reduce the Company's exposure to the impact of inflation.

Three Months Ended March 31, 2005 Compared To Three Months Ended March 31, 2004

Results of Operations: Net income allocable to common shareholders for the three months ended March 31, 2005 was \$7.3 million or \$0.33 per diluted share compared to \$4.2 million or \$0.19 per diluted share for the same period in 2004. The change resulted primarily from a gain on the disposition of real estate of \$2.9 million in the first quarter of 2005. In addition, the Company reported non-cash distributions of \$2.1 million during the first quarter of 2004 related to the redemption of preferred equity in April 2004 and the application of EITF Topic D-42. These non-cash distributions were partially offset by an increase of \$1.7 million in preferred equity distributions related to preferred stock issuances throughout 2004

Revenues increased \$2.1 million for the three months ended March 31, 2005 over the same period in 2004 as a result of continued lease up of the Company's portfolio.

The Company's property operations account for almost all of the net operating income earned by the Company. The following table presents the operating results of the properties for the three months ended March 31, 2005 and 2004 in addition to other income and expense items affecting income from continuing operations. The Company breaks out Same Park operations to provide information regarding trends for properties the Company has held for the periods being compared (in thousands, except per square foot amounts):

	Three Months Ended		Change
	March 31,		
	2005	2004	
Rental income:			
Same Park facilities (17.7 million net rentable square feet) (1)....	\$ 54,944	\$ 53,610	2.5%
Other facilities (165,000 net rentable square feet) (2)	797	—	100.0%
Total rental income	<u>55,741</u>	<u>53,610</u>	<u>4.0%</u>
Cost of operations (excluding depreciation):			
Same Park facilities.....	16,084	16,116	(0.2%)
Other facilities.....	304	—	100.0%
Total cost of operations (excluding depreciation).....	<u>16,388</u>	<u>16,116</u>	<u>1.7%</u>
Net operating income (rental income less cost of operations)(3):			
Same Park facilities.....	38,860	37,494	3.6%
Other facilities.....	493	—	100.0%
Total net operating income.....	<u>39,353</u>	<u>37,494</u>	<u>5.0%</u>
Other income and expenses:			
Facility management fees.....	145	155	(6.5)%
Interest and other income	398	27	1,374.1%
Interest expense.....	(282)	(1,266)	(77.7)%
Depreciation and amortization	(19,016)	(17,404)	9.3%
General and administrative.....	(1,438)	(1,091)	31.8%
Income before discontinued operations and minority interest.....	<u>\$ 19,160</u>	<u>\$ 17,915</u>	<u>6.9%</u>
Same Park gross margin(4)	70.7%	69.9%	1.1%
Same Park weighted average for period:			
Occupancy.....	90.8%	88.6%	2.5%
Annualized realized rent per square foot(5).....	\$ 13.69	\$ 13.69	0.0%

(1) See "Supplemental Property Data and Trends" below for a definition of Same Park facilities.

(2) Represents assets owned by the Company as of March 31, 2005 that are not included in the Same Park facilities.

(3) Net operating income ("NOI") is an important measurement in the commercial real estate industry for determining the value of the real estate generating the NOI. See "Concentration of Portfolio by Region" below for more information on NOI. The Company's calculation of NOI may not be comparable to those of other companies and should not be used as an alternative to measures of performance in accordance with generally accepted accounting principles.

(4) Gross margin is computed by dividing NOI by rental income.

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

Concentration of Portfolio by Region: Rental income, cost of operations and rental income less cost of operations, excluding depreciation and amortization or net operating income prior to depreciation and amortization (defined as "NOI" for purposes of the following tables) from continuing operations are summarized for the three months ended March 31, 2005 by major geographic region below. The Company uses NOI and its components as a measurement of the performance of its commercial real estate. Management believes that these financial measures provide them as well as the investor the most consistent measurement on a comparative basis of the performance of the commercial real estate and its contribution to the value of the Company. Depreciation and amortization have been excluded from these financial measures as they are generally not used in determining the value of commercial real estate by management or the investment community. Depreciation and amortization are generally not used in determining value as they consider the historical costs of an asset compared to its current value; therefore, to

understand the effect of the assets' historical cost on the Company's results, investors should look at GAAP financial measures, such as total operating costs including depreciation and amortization. The Company's calculation of NOI may not be comparable to those of other companies and should not be used as an alternative to measures of performance calculated in accordance with generally accepted accounting principles. The table below reflects rental income, operating expenses and NOI from continuing operations for the three months ended March 31, 2005 based on geographical concentration. The total of all regions is equal to the amount of rental income and cost of operations recorded by the Company in accordance with Generally Accepted Accounting Principles (GAAP). We have also included the most comparable GAAP measure which includes total depreciation and amortization. The percent of totals by region reflects the actual contribution to rental income, cost of operations and NOI during the period from properties included in continuing operations (*in thousands*):

Three Months Ended March 31, 2005:

<u>Region</u>	<u>Weighted Square Footage</u>	<u>Percent of Total</u>	<u>Rental Income</u>	<u>Percent of Total</u>	<u>Cost of Operations</u>	<u>Percent of Total</u>	<u>NOI</u>	<u>Percent of Total</u>
Southern California	3,663	20.5%	13,478	24.2%	3,615	22.0%	9,863	25.1%
Northern California	1,497	8.4%	4,511	8.1%	1,090	6.7%	3,421	8.7%
Southern Texas	1,163	6.5%	2,280	4.1%	1,005	6.1%	1,275	3.3%
Northern Texas	1,689	9.4%	3,686	6.6%	1,075	6.6%	2,611	6.6%
Florida	3,191	17.9%	5,387	9.7%	1,796	11.0%	3,591	9.1%
Virginia	2,786	15.6%	11,456	20.6%	3,611	22.0%	7,845	19.9%
Maryland	1,242	7.0%	6,096	10.9%	1,682	10.3%	4,414	11.2%
Oregon	1,939	10.9%	7,157	12.8%	1,888	11.5%	5,269	13.4%
Arizona	679	3.8%	1,690	3.0%	626	3.8%	1,064	2.7%
Total before depreciation and amortization	<u>17,849</u>	<u>100%</u>	<u>55,741</u>	<u>100%</u>	<u>\$ 16,388</u>	<u>100%</u>	<u>\$ 39,353</u>	<u>100%</u>
Depreciation and amortization					<u>19,016</u>		<u>(19,016)</u>	
Total based on GAAP			<u>\$ 55,741</u>		<u>\$ 35,404</u>		<u>\$ 20,337</u>	

Concentration of Credit Risk by Industry: The information below depicts the industry concentration of our tenant base as of March 31, 2005. The Company analyzes this concentration to minimize significant industry exposure risk.

Computer hardware, software, and related service	12.4%
Business services	12.0%
Government	9.9%
Contractors	9.5%
Financial services	9.1%
Warehouse, transportation, logistics	8.4%
Retail	6.2%
Home furnishing	4.6%
Electronics	4.4%
Communications	4.0%
	<u>80.5%</u>

The information below depicts the Company's top ten customers by annual rents as of March 31, 2005 (in thousands):

<u>Tenants</u>	<u>Square Footage</u>	<u>Annual Rents</u>	<u>% of Total Annual Rents</u>
U.S. Government	463	\$ 10,206	4.6%
Citigroup	262	3,805	1.7%
Intel	214	3,679	1.7%
County of Santa Clara	97	2,951	1.3%
IBM	180	2,676	1.2%
Axcelis Technologies	89	1,656	0.7%
Wells Fargo	102	1,571	0.7%
AARP	102	1,398	0.6%
Welch Allyn Protocol, Inc.	91	1,357	0.6%
TRW System	58	1,319	0.6%
	<u>1,658</u>	<u>\$ 30,618</u>	<u>13.7%</u>

Of the leases included in the above list, approximately 19.4% of the total square footage is currently scheduled to expire in 2005.

Supplemental Property Data and Trends: In order to evaluate the performance of the Company's overall portfolio over two given periods, management analyzes the operating performance of a consistent group of properties owned and operated throughout both those years. The Company refers to those properties as the Same Park facilities. For the three months ended March 31, 2005 and 2004, the Same Park facilities constitute 17.7 million net rentable square feet, include all assets included in continuing operations that the Company owned and operated from January 1, 2004 through March 31, 2005, and represent approximately 99% of the weighted average square footage of the Company's portfolio for 2005.

Rental income, cost of operations and rental income less cost of operations, excluding depreciation and amortization or net operating income prior to depreciation and amortization (defined as "NOI" for purposes of the following tables) from continuing operations are summarized for the three months ended March 31, 2005 and 2004 by major geographic region below. See "Concentration of Portfolio by Region" above for more information on NOI, including why the Company presents NOI and how the Company uses NOI. The Company's calculation of NOI may not be comparable to those of other companies and should not be used as an alternative to measures of performance calculated in accordance with generally accepted accounting principles.

The following table summarizes the Same Park operating results by major geographic region for the three months ended March 31, 2005 and 2004. In addition, the table reflects the comparative impact on the overall rental income, cost of operations and NOI from properties that have been acquired since January 1, 2004 (referred to as "Other Facilities"). The impact of these properties is included in Other Facilities in the table below (in thousands):

<u>Region</u>	<u>Revenues</u> <u>March 31,</u> <u>2005</u>	<u>Revenues</u> <u>March 31,</u> <u>2004</u>	<u>Increase</u> <u>(Decrease)</u>	<u>Cost of</u> <u>Operations</u> <u>March 31,</u> <u>2005</u>	<u>Cost of</u> <u>Operations</u> <u>March 31,</u> <u>2004</u>	<u>Increase</u> <u>(Decrease)</u>	<u>NOI</u> <u>March 31,</u> <u>2005</u>	<u>NOI</u> <u>March 31,</u> <u>2004</u>	<u>Increase</u> <u>(Decrease)</u>
Southern California.....	13,478	12,779	5.5%	3,615	3,518	2.8%	9,863	9,261	6.5%
Northern California.....	4,511	5,000	(9.8%)	1,090	1,164	(6.4%)	3,421	3,836	(10.8%)
Southern Texas.....	2,280	2,539	(10.2%)	1,005	1,110	(9.5%)	1,275	1,429	(10.8%)
Northern Texas.....	3,686	3,499	5.3%	1,075	1,339	(19.7%)	2,611	2,160	20.9%
Florida.....	5,387	5,099	5.6%	1,796	1,788	0.4%	3,591	3,311	8.5%
Virginia.....	10,659	10,955	(2.7%)	3,307	3,243	2.0%	7,352	7,712	(4.7%)
Maryland.....	6,096	5,963	2.2%	1,682	1,666	1.0%	4,414	4,297	2.7%
Oregon.....	7,157	6,066	18.0%	1,888	1,576	19.8%	5,269	4,490	17.3%
Arizona.....	<u>1,690</u>	<u>1,710</u>	<u>(1.2%)</u>	<u>626</u>	<u>712</u>	<u>(12.1%)</u>	<u>1,064</u>	<u>998</u>	<u>6.6%</u>
Total Same Park.....	54,944	53,610	2.5%	16,084	16,116	(0.2%)	38,860	37,494	3.6%
Other Facilities.....	<u>797</u>	<u>—</u>	<u>100.0%</u>	<u>304</u>	<u>—</u>	<u>100.0%</u>	<u>493</u>	<u>—</u>	<u>100.0%</u>
Total before depreciation and amortization.....	55,741	53,610	4.0%	16,388	16,116	1.7%	39,353	37,494	5.0%
Depreciation and amortization.....	<u>—</u>	<u>—</u>	<u>—</u>	<u>19,016</u>	<u>17,404</u>	<u>9.3%</u>	<u>(19,016)</u>	<u>(17,404)</u>	<u>9.3%</u>
Total based on GAAP.....	<u>55,741</u>	<u>53,610</u>	<u>4.0%</u>	<u>35,404</u>	<u>33,520</u>	<u>5.6%</u>	<u>20,337</u>	<u>20,090</u>	<u>1.2%</u>

Southern California (Same Park)

This region includes San Diego, Orange and Los Angeles Counties. The increase in revenues is the result of a stable market with a diverse economy. Weighted average occupancies have increased from 92.4% for the first three months in 2004 to 95.2% for the first three months in 2005. Annualized realized rent per foot increased 2.4% from \$15.10 per foot for the first three months in 2004 to \$15.46 per foot for the first three months in 2005.

Northern California (Same Park)

This region includes San Jose, San Francisco and Sacramento, including 1,025,000 square feet in the Silicon Valley, a market that has been devastated by the technology slump. The Company benefited from the early renewal of large leases in its Silicon Valley portfolio and relative strength in the Sacramento market. Weighted average occupancies have outperformed the market, yet they have decreased from 95.6% for the first three months in 2004 to 94.6% for the first three months in 2005. Annualized realized rent per foot decreased 8.9% from \$13.98 per foot for the first three months in 2004 to \$12.74 per foot for the first three months in 2005.

Southern Texas (Same Park)

This includes Austin and Houston. Austin was among the hardest hit due to the technology slump and the Company's operating results reflect the effects of sharply reduced market rental rates, higher vacancies and business failures. The leasing activity in the Austin market has increased in late 2004 into 2005. The Houston market has experienced some decline in operating conditions, primarily due to the loss of certain large tenants. Weighted average occupancies have decreased from 87.0% for the first three months in 2004 to 81.8% for the first three months in 2005. Annualized realized rent per foot decreased 4.5% from \$10.04 per foot for the first three months in 2004 to \$9.59 per foot for the first three months in 2005.

Northern Texas (Same Park)

This region consists of the Company's Dallas portfolio, which continues to be negatively impacted by the lingering effects of the slowdown in the telecommunications industry, however there are signs of recovery. Weighted average occupancies have increased from 84.4% for the first three months in 2004 to 84.6% for the first three months in 2005. Annualized realized rent per foot increased 5.2% from \$9.81 per foot for the first three months in 2004 to \$10.32 per foot for the first three months in 2005.

Florida (Same Park)

This region consists of facilities in the sub-market of Miami-Dade County. The park is located less than 1 mile from the Miami International Airport, which is considered one of the busiest in the country. Weighted average occupancies have increased 8.3% from 83.0% for the first three months in 2004 to 91.4% for the first three months in 2005. Annualized realized rent per foot decreased 4.0% from \$7.70 per foot for the first three months in 2004 to \$7.39 for the first three months in 2005.

Virginia (Same Park)

This region includes all major Northern Virginia submarkets surrounding the Washington D.C. metropolitan area. Virginia has been negatively impacted in the Chantilly and Herndon submarkets as a result of the technology and telecommunications industry slowdown. Other submarkets have been positively impacted by increased federal government spending. Weighted average occupancies have decreased from 96.2% for the first three months in 2004 to 95.5% for the first three months in 2005. Annualized realized rent per foot decreased 2.1% from \$17.39 per foot for the first three months in 2004 to \$17.03 per foot for the first three months in 2005.

Maryland (Same Park)

This region consists primarily of facilities in Prince Georges County and Montgomery County. Despite increased occupancy, this market is experiencing the effects of the telecommunications slowdown with lower rental rates. Weighted average occupancies are 87.7% for the first three months in 2004 and 93.3% for the first three months in 2005. Annualized realized rent per foot decreased 3.9% from \$21.89 per foot for the first three months in 2004 to \$21.04 per foot for the first three months in 2005.

Oregon (Same Park)

This region consists primarily of three business parks in the Beaverton submarket of Portland. Oregon has been one of the markets hardest hit by the technology slowdown. The slowdown began in 2003 and continued through 2004, with lease terminations and expirations resulting in significant declines in rental revenue. Going into 2005, the market has experienced an increase in activity that may indicate the market has bottomed and may be beginning to improve.

Weighted average occupancies have increased from 78.1% for the first three months in 2004 to 80.4% for the first three months in 2005. Annualized realized rent per foot increased 14.5% from \$16.03 per foot for the first three months in 2004 to \$18.36 per foot for the first three months in 2005.

Arizona (Same Park)

This region consists primarily of Phoenix and Tempe. Weighted average occupancies have decreased from 94.3% for the first three months in 2004 to 93.3% for the first three months in 2005. Annualized realized rent per foot decreased 0.2% from \$10.69 per foot for the first three months in 2004 to \$10.67 for the first three months in 2005.

Other Facilities

In May, 2004, the Company acquired one asset consisting of 165,000 square feet for \$22.4 million. During the three months ended March 31, 2005 this recently acquired asset (referred to as Other Facilities) contributed \$797,000 in revenues less cost of operations of \$304,000.

Facility Management Operations: The Company's facility management operations account for a small portion of the Company's net income. During the three months ended March 31, 2005, \$145,000 in revenue was recognized from facility management operations compared to \$155,000 for the same period in 2004.

Cost of Operations: Cost of operations for the three months ended March 31, 2005 was \$16.4 million compared to \$16.1 million for the same period in 2004, an increase of 1.9%. Cost of operations as a percentage of rental income remained fairly consistent for the three months ended March 31, 2005 and 2004 at 29.4% and 30.1%, respectively.

Depreciation and Amortization Expense: Depreciation and amortization expense for the three months ended March 31, 2005 was \$19.0 million compared to \$17.4 million for the same period in 2004. This increase is primarily due to depreciation expense on capital and tenant improvements acquired during 2004.

General and Administrative Expense: General and administrative expense consisted of the following expenses (in thousands):

	For the Three Months Ended		Increase
	March 31,		(Decrease)
	2005	2004	
Compensation expense	845	575	47.0%
Professional fees	170	78	117.9%
Stock option and stock compensation expense	119	143	(16.8%)
Other expenses	304	295	3.1%
	<u>1,438</u>	<u>1,091</u>	<u>31.8%</u>

For three months ended March 31, 2005, general and administrative costs have increased \$347,000 or 31.8% over the same period in 2004. The primary cause of the increase relates to payroll expenses as a result of the addition of the Company's Chief Operating Officer along with additional resources in the Company's finance group.

Interest and Other Income: Interest and other income reflect earnings on cash balances and dividends on marketable securities in addition to miscellaneous income items. Interest income was \$340,000 for the three months ended March 31, 2005 compared to \$18,000 for the same period in 2004. The increase is attributable to higher cash balances and higher effective interest rates. Average cash balances and effective interest rates for the three months ended March 31, 2005 were approximately \$50.7 million and 2.7%, respectively, compared to \$5.5 million and 1.3% respectively, for the same period in 2004.

Interest Expense: Interest expense was \$282,000 for the three months ended March 31, 2005 compared to \$1.3 million for the same period in 2004. The decrease is primarily attributable to lower average debt balances in 2005 due to refinancing debt with preferred equity.

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 was \$5.1 million (\$2.7 million allocated to preferred unit holders and \$2.5 million allocated to common unit holders) for the three months

ended March 31, 2005 compared to \$6.5 million (\$5.1 million allocated to preferred unit holders, \$1.4 million allocated to common unit holders) for the same period in 2004.

Liquidity and Capital Resources

Cash and cash equivalents increased 55.4% from \$39.7 million at December 31, 2004 to \$61.7 million at March 31, 2005. The primary reasons for the increase were the proceeds from the sale of assets during the first quarter as well as retained operating cash flow. Subsequent to March 31, 2005 the Company raised \$79.9 million in net proceeds from the issuance of cumulative preferred equity. Proceeds from the issuance will be used to fund future preferred equity redemptions.

Net cash provided by operating activities for the three months ended March 31, 2005 and 2004 was \$36.6 million and \$35.8 million, respectively. Management believes that the Company's 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 in addition to providing additional cash for future growth, debt repayment, and stock repurchases.

Net cash provided by investing activities was \$5.6 million for the three months ended March 31, 2005 compared to cash used in investing activities of \$6.1 million in the three months ended March 31, 2004. During the first quarter of 2005 the Company received \$15.3 million in proceeds from the sale of real estate which partially offset by \$9.6 million in cash used for capital improvements. For the three months ended March 31, 2004, the Company incurred capital expenditures of \$6.1 million. The increase in capital expenditures of \$3.5 million is a result of rising transaction costs. Transaction costs, which include tenant improvements and leasing commissions, began to escalate during 2004 and have continued to run at historically high levels as a result of soft market conditions in markets such as Oregon, Texas and Northern California.

Net cash used in financing activities was \$20.2 million for the three months ended March 31, 2005 compared to \$30.4 million for the same period of 2004. The decrease of \$10.2 million is primarily a result of the use of \$17.3 million of operating cash to repay debt and preferred equity partially offset by a reduction in cash provided by the exercise of stock options of approximately \$5.3 million.

The Company's capital structure is characterized by a low level of leverage. As of March 31, 2005, the Company had two fixed rate mortgages totaling \$11.3 million, which represented approximately 1.0% of its total capitalization (based on book value, including minority interest and debt). The weighted average interest rate for the mortgages is approximately 7.73% per annum. The Company had approximately 1.3% of its properties, in terms of net book value, encumbered at March 31, 2005.

Subsequent to March 31, 2004, the Company issued 3.3 million depositary shares each representing 1/1,000 of a share of the 7.200% Cumulative Preferred Stock, Series M, at a par value of \$25.00 per depositary share. The intended use of the proceeds from the offering will be to fund future preferred equity redemptions.

The Company has an unsecured line of credit (the "Credit Facility") with Wells Fargo Bank, with a borrowing limit of \$100 million and an expiration date of August 1, 2005. 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 0.60% to LIBOR plus 1.20% depending on the Company's credit ratings and coverage ratios, as defined (currently LIBOR plus 0.70%). In addition, the Company is required to pay an annual commitment fee ranging from 0.20% to 0.35% of the borrowing limit (currently 0.25%). The Company had no balance outstanding as of March 31, 2005 and December 31, 2004.

Non-GAAP Supplemental Disclosure Measure: Funds from Operations: Management believes that Funds From Operations ("FFO") is a useful supplemental measure of the Company's operating performance. The Company computes FFO in accordance with the White Paper on FFO approved by the Board of Governors of the National Association of Real Estate Investment Trusts ("NAREIT"). The White Paper defines FFO as net income, computed in accordance with generally accepted accounting principles ("GAAP"), before depreciation, amortization, minority interest in income, and extraordinary items. Management believes that FFO provides a useful measure of the Company's operating performance and when compared year over year, reflects the impact to

operations from trends in occupancy rates, rental rates, operating costs, development activities, general and administrative expenses and interest costs, providing a perspective not immediately apparent from net income.

FFO should be analyzed in conjunction with net income. However, FFO should not be viewed as a substitute for net income as a measure of operating performance or liquidity as it does not reflect depreciation and amortization costs or the level of capital expenditure and leasing costs necessary to maintain the operating performance of the Company's properties, which are significant economic costs and could materially impact the Company's results from operations.

Management believes FFO provides useful information to the investment community about the Company's operating performance when compared to the performance of other real estate companies as FFO is generally recognized as the industry standard for reporting operations of real estate investment trusts ("REIT"). Other REITs may use different methods for calculating FFO and, accordingly, our FFO may not be comparable to other real estate companies.

FFO for the Company is computed as follows (in thousands):

	Three Months Ended	
	March 31,	
	<u>2005</u>	<u>2004</u>
Net income allocable to common shareholders.....	\$ 7,324	\$ 4,158
Gain on disposition of real estate	(2,914)	—
Depreciation and amortization	19,016	17,884
Minority interest in income – common units	<u>2,455</u>	<u>1,405</u>
Consolidated FFO allocable to common shareholders and minority interests	25,881	23,447
FFO allocated to minority interests – common units	<u>(6,496)</u>	<u>(5,889)</u>
FFO allocated to common shareholders.....	<u>\$ 19,385</u>	<u>\$ 17,558</u>

FFO allocated to common shareholders for the three months ended March 31, 2005, increased 10.4% from the same period in 2004. FFO for the three months ended March 31, 2004 included non-cash distributions of \$2.1 million related to the application of EITF Topic D-42 and the redemption of preferred equity completed in April 2004. The change in FFO relates to an increase in the Same Park operating results of approximately \$1.9 million and Other Facility operating results of \$493,000, offset by an increase in preferred equity distributions.

Capital Expenditures: During the three months ended March 31, 2005, the Company incurred approximately \$8.3 million in recurring capital expenditures or \$0.46 per weighted average square foot owned. The Company defines recurring capital expenditures as those necessary to maintain and operate its commercial real estate of its current economic value. During the three months ended March 31, 2004, the Company incurred approximately \$5.1 million in recurring capital expenditures or \$0.28 per weighted average square foot owned. Recurring capital expenditures may be at higher levels over the remainder of 2005 similar to 2004. The following table shows total capital expenditures for the stated periods (in thousands):

	Three Months Ended	
	March 31,	
	<u>2005</u>	<u>2004</u>
Recurring capital expenditures	\$ 8,340	\$ 5,119
Property renovations and other capital expenditures.....	<u>1,288</u>	<u>1,007</u>
Total capital expenditures	<u>\$ 9,628</u>	<u>\$ 6,126</u>

Stock Repurchase: The Company's Board of Directors has authorized the repurchase, from time to time, of up to 4.5 million shares of the Company's common stock on the open market or in privately negotiated transactions. Since the inception of the program (March 2000), the Company has repurchased an aggregate total of 2.6 million shares of common stock and 30,484 common units in its operating partnership at an aggregate cost of approximately \$70.7 million (average cost of \$ 26.66 per share/unit). No shares were repurchased during the three months ended March 31, 2005.

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.

Related Party Transactions: At March 31, 2005, PSI owned 25% of the outstanding shares of the Company's common stock (44% upon conversion of its interest in the Operating Partnership) and 25% of the outstanding common units of the Operating Partnership (100% of the common units not owned by the Company). Ronald L. Havner, Jr., the Company's chairman (and until August 2003 also the Chief Executive Officer), is also the vice-chairman, chief executive officer and a director of PSI.

Pursuant to a cost sharing and administrative services agreement, the Company shares costs with PSI and affiliated entities for certain administrative services, which are allocated among PSI and its affiliates in accordance with a methodology intended to fairly allocate those costs. These costs totaled approximately \$85,000 and \$84,000 or each of the three months ended March 31, 2005 and 2004, respectively. In addition, the Company provides property management services for properties owned by PSI and its affiliates for a fee of 5% of the gross revenues of such properties in addition to reimbursement of direct costs. These management fee revenues recognized under management contracts with affiliated parties totaled approximately \$145,000 and \$138,000 for the three months ended March 31, 2005, and 2004, respectively. In addition, through the first quarter of 2004, the Company combined its insurance purchasing power with PSI through a captive insurance company controlled by PSI, STOR-Re Mutual Insurance Corporation ("Stor-Re"). Stor-Re provides limited property and liability insurance to the Company at commercially competitive rates. The Company and PSI also utilize unaffiliated insurance carriers to provide property and liability insurance in excess of Stor-Re's limitations.

Off-Balance Sheet Arrangements: The Company does not have any off-balance sheet arrangements.

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.

Public Storage has significant influence over us.

At March 31, 2005, Public Storage and its affiliates owned 25% of the outstanding shares of our common stock (44% upon conversion of its interest in our operating partnership) and 25% of the outstanding common units of our operating partnership (100% of the common units not owned by us). Also, Ronald L. Havner, Jr., our Chairman of the Board, is also Vice-Chairman, Chief Executive Officer and a Director of Public Storage and Harvey Lenkin, one of our Directors, is President, Chief Operating Officer, and a Director of Public Storage. Consequently, Public Storage 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 such as mergers, and all matters requiring the consent of the limited partners of the operating partnership. In addition, Public Storage's ownership may make it more difficult for another party to take over our company without Public Storage's approval.

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 other person, and the partnership agreement of our operating partnership contains an anti-takeover provision. No shareholder (other than Public Storage 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 REIT. This limitation, however, also makes a change of control much more difficult (if not impossible) even if it may be favorable to our public shareholders. These provisions will prevent future takeover attempts not approved by Public Storage 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 50.0 million shares of preferred stock and up to 100.0 million 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 generally provides that we may not merge or engage in a similar transaction unless the 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 unless the merger would have been approved had the limited partners been able to vote together with our shareholders, which has the effect of increasing Public Storage's influence over us due to Public Storage's ownership of operating partnership units. 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 Public Storage, have the right to vote on certain changes to the partnership agreement. They may vote in a way that is against 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 the operating partnership. The interests of the limited partners and of our shareholders may differ.

We cannot sell certain properties without Public Storage's approval.

Prior to 2007, we are prohibited from selling 10 specified properties without Public Storage's approval. Since Public Storage would be taxed on a sale of these properties, the interests of Public Storage and our shareholders may differ as to the best time to sell.

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 so 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;
- environmental issues;
- compliance with the Americans with Disabilities Act and other federal, state, and local laws and regulations;
- increasing operating costs, including real estate taxes, insurance and utilities, if these increased costs cannot be passed through to tenants;
- changes in tax, real estate and zoning laws;
- increase in new commercial properties in our market;
- tenant defaults and bankruptcies;
- tenant's right to sublease space, and
- concentration of properties leased to non-rated private companies.

Certain significant costs, such as mortgage payments, real estate taxes, insurance and maintenance, 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 and expense in reletting vacant space, or we may not be able to relet space at existing rates, in each case resulting in losses of income: When leases expire, we will incur expenses in retrofitting space 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. Our properties as of March 31, 2005 generally have lower vacancy rates than the average for the markets in which they are located, and leases accounting for 17.7% of our annual rental income expire in 2005 and 21.6% in 2006. While we have estimated our cost of renewing leases that expire in 2005 and 2006, 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 bankruptcy. This could affect our cash flow and distributions to shareholders. Since many of our tenants are non-rated private companies, this risk may be enhanced.

The Company has a lease with Footstar that generates less than 1% of our revenues. Footstar and its affiliates filed for protection under Chapter 11 of the U.S. Bankruptcy Laws in 2004. In connection with such filing, they immediately rejected one of two leases with the Company. The rejected lease consisted of approximately 60,000 square feet in Dallas, Texas, with annual rents of approximately \$620,000. The court has not approved Footstar's petition to reject the remaining lease. The Company has taken back approximately 13,400 square feet of the original 57,000 square foot lease in order to execute a lease with another tenant. The remaining Footstar lease generates annual rents of approximately \$740,000. In September 2004, the Company restructured a 134,000 square foot lease with a previous top ten tenant in Northern California that reset the term to 10 years and reduced the initial monthly rents by approximately \$120,000 per month, with annual increases thereafter. Additionally, a tenant occupying approximately 91,000 square feet in Northern California, with annual rents of approximately \$600,000, filed for protection under Chapter 11 of the U.S. Bankruptcy Laws on April 12, 2005. On April 19, 2005 the petition to reject the Company's lease was accepted by the court. The tenant vacated prior to filing the petition, which has allowed the Company to actively market the space. Several other tenants have contacted us, requesting early termination of their lease, reduction in space under lease, rent deferment or abatement. At this time, the Company cannot anticipate what impact, if any, the ultimate outcome of these discussions will have on our operating results.

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

We may be adversely affected if casualties to 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 or losses in excess of policy limits for such occurrences such as earthquakes that adversely affect us or even result in loss of the property. We might still remain liable on any mortgage debt or other unsatisfied obligations 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 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 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. We have an ongoing program to bring our properties into what we believe is compliance with the Americans with Disabilities Act.

We depend on external sources of capital to grow our company.

We are generally required under the Internal Revenue Code to distribute at least 90% of our taxable income. Because of this distribution requirement, we may not be able to fund future capital needs, including any necessary building and tenant improvements, from operating cash flow. Consequently, we may need to rely on third-party sources of capital to fund our capital needs. We may not be able to obtain the financing on favorable terms or at all. Access to third-party sources of capital depends, in part, on general market conditions, the market's perception of our growth potential, our current and expected future earnings, our cash flow, and the market price per share of our common stock. If we cannot obtain capital from third-party sources, we may not be able to acquire properties when strategic opportunities exist, satisfy any debt service obligations, or make cash distributions to shareholders.

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 prevent us from acquiring properties with others through 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. During 2001, we entered into a joint venture arrangement that held property subject to debt. This joint venture has been liquidated and all debts paid; however, we may enter into similar arrangements with the same partner or other partners.

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, equity and common stock without shareholder approval. Holders of preferred stock have priority over holders of common stock, and the issuance of additional shares of 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. As of March 31, 2005, Public Storage and its affiliates owned 25% of the outstanding shares of our common stock (44% upon conversion of its interest in our operating partnership). These shares, as well as shares of common stock held by certain other significant stockholders, are eligible to be sold in the public market, subject to compliance with applicable securities laws.

We depend on key personnel.

We depend on our key personnel, including Ronald L. Havner, Jr., our Chairman of the Board, and Joseph D. Russell, Jr., our President and Chief Executive Officer. The loss of Mr. Havner, Mr. Russell, or other key personnel could adversely affect our operations. We maintain no key person insurance on our key personnel.

Terrorist attacks and the possibility of wider armed conflict may have an adverse impact on our business and operating results and could decrease the value of our assets.

Terrorist attacks and other acts of violence or war, such as those that took place on September 11, 2001, could have a material adverse impact on our business and operating results. There can be no assurance that there will not be further terrorist attacks against the United States or its businesses or interests. Attacks or armed conflicts that directly impact one or more of our properties could significantly affect our ability to operate those properties and thereby impair our operating results. Further, we may not have insurance coverage for all losses caused by a terrorist attack. Such insurance may not be available, or if it is available and we decide to obtain such terrorist coverage, the cost for the insurance may be significant in relationship to the risk overall. In addition, the adverse effects that such violent acts and threats of future attacks could have on the U.S. economy could similarly have a material adverse effect on our business and results of operations. Finally, further terrorist acts could cause the United States to enter into a wider armed conflict which could further impact our business and operating results.

We may be affected by California's budget shortfall.

The California budget could affect our company in many ways, including the possible repeal of Proposition 13, which could result in higher property taxes. Reduced state and local government spending and the resulting effects on the state and local economies could have an adverse impact on demand for our space. The budget shortfall could impact our company in other ways that cannot be predicted. Approximately 33.8% of our properties' net operating income was generated in California for the three months ended March 31, 2005.

Change in taxation of corporate dividends may adversely affect the value of our shares.

The Jobs and Growth Tax Relief Reconciliation Act of 2003, enacted on May 28, 2003, generally reduces to 15% the maximum marginal rate of federal tax payable by individuals on dividends received from a regular C corporation. This reduced tax rate, however, will not apply to dividends paid to individuals by a REIT on its shares except for certain limited amounts. The earnings of a REIT that are distributed to its shareholders still will generally be subject to less federal income taxation on an aggregate basis than earnings of a non-REIT C corporation that are distributed to its shareholders net of corporate-level income tax. The Jobs and Growth Tax Act, however, could cause individual investors to view stocks of regular C corporations as more attractive relative to shares of REITs than was the case prior to the enactment of the legislation because the dividends from regular C corporations, which previously were taxed at the same rate as REIT dividends, now will be taxed at a maximum marginal rate of 15% while REIT dividends will be taxed at a maximum marginal rate of 35%. We cannot predict what effect, if any, the enactment of this legislation may have on the value of our common stock, either in terms of price or relative to other investments.

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 March 31, 2005, the Company's debt as a percentage of shareholders' equity and minority interest (based on book values) was 0.9%.

The Company's market risk sensitive instruments include mortgage notes payable of \$11.3 million at March 31, 2005. All of the Company's mortgage notes payable bear interest at fixed rates. See Notes 5 and 6 of the Notes to Consolidated Financial Statements for terms, valuations and approximate principal maturities of the mortgage notes payable and line of credit as of March 31, 2005. Based on borrowing rates currently available to the Company, combined with the amount of fixed rate debt financing, the difference between the carrying amount of debt and its fair value is insignificant.

ITEM 4. CONTROLS AND PROCEDURES

(a) *Evaluation of disclosure controls and procedures.* The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed by the Company in reports the Company files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and that such information is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure based on the definition of "disclosure controls and procedures" in Rule 13a-15(e) of the Exchange Act. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures in reaching that level of reasonable assurance. As of the end of the fiscal quarter ended March 31, 2005, the Company's management carried out an evaluation, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the Company's disclosure controls and procedures. Based upon this evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the fiscal quarter ended March 31, 2005, the Company's disclosure controls and procedures were effective.

(b) *Changes in internal control over financial reporting.* There has not been any change in the Company's internal control over financial reporting that occurred during the fiscal quarter ended March 31, 2005 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The information contained in Note 10 to the Consolidated Financial Statements in this Form 10-Q regarding legal proceedings is incorporated by reference in this Item 1.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

In March 2000, the Company publicly announced that the Board of Directors had authorized the repurchase of up to 4.5 million shares of the Company's Common Stock (the "Program"). The Company has repurchased an aggregate of 2.6 million shares of Common Stock under the Program since inception. The Company did not repurchase any shares of Common Stock under the Program during the three months ended March 31, 2005. Unless terminated earlier by resolution of the Board of Directors, the Program will expire when the Company has repurchased all shares of Common Stock authorized for repurchase thereunder.

ITEM 6. EXHIBITS

Exhibits

- Exhibit 3.1 Certificate of Determination of Preferences of 7.20% Cumulative Preferred Stock, Series M of PS Business Parks, Inc. filed with Registrant's Current Report on Form 8-K, dated April 28, 2005 and incorporated herein by reference.
- Exhibit 4.1 Deposit Agreement Relating to 7.20% Cumulative Preferred Stock, Series M of PS Business Parks, Inc., dated as of May 2, 2005. Filed with Registrant's Current Report on Form 8-K dated April 28, 2005 and incorporated herein by reference.
- Exhibit 4.2 Specimen Stock Certificate for Registrant's 7.20% Cumulative Preferred Stock, Series M. Filed with Registrant's Current Report on Form 8-K dated April 28, 2005 and incorporated herein by reference.
- Exhibit 10.1 Amendment to Agreement of Limited Partnership of PS Business Parks L.P. relating to 7.20% Cumulative Preferred Stock, Series M, dated as of May 2, 2005. Filed herewith.
- Exhibit 12 Statement re: Computation of Ratio of Earnings to Fixed Charges. Filed herewith.
- Exhibit 31.1 Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer. Filed herewith.
- Exhibit 31.2 Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer. Filed herewith.
- Exhibit 32.1 Certifications of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. Filed herewith.

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: May 9, 2005

PS BUSINESS PARKS, INC.

BY: /s/ Edward A. Stokx

Edward A. Stokx
Executive Vice President and Chief Financial
Officer
(Principal Financial Officer)

EXHIBIT INDEX

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PS BUSINESS PARKS, L.P.
AMENDMENT TO AGREEMENT OF LIMITED
PARTNERSHIP RELATING TO
7.20% SERIES M CUMULATIVE REDEEMABLE
PREFERRED UNITS

This Amendment to the Agreement of Limited Partnership of PS Business Parks, L.P., a California limited partnership (the “**Partnership**”), dated as of May 2, 2005 (this “**Amendment**”), amends the Agreement of Limited Partnership of the Partnership, dated as of March 17, 1998, as amended, by and among PS Business Parks, Inc. (the “**General Partner**”) and each of the limited partners described on Exhibit A to that partnership agreement (the “**Partnership Agreement**”). Section references are (unless otherwise specified) references to sections in this Amendment.

WHEREAS, the General Partner agreed to issue 3,000,000 Depositary Shares each representing 1/1000th of a share of the General Partner’s preferred stock designated as the “7.20% Cumulative Preferred Stock, Series M” (the “**Depositary Shares**”) for a price of \$25.00 per Depositary Share;

WHEREAS, Section 4.1(b)(2) of the Partnership Agreement requires the General Partner to contribute to the Partnership the funds raised through the issuance of additional shares of the General Partner in return for additional Partnership Units, and provides that the General Partner’s capital contribution shall be deemed to equal the amount of the gross proceeds of that share issuance (i.e., the net proceeds actually contributed, plus any underwriter’s discount or other expenses incurred, with any such discount or expense deemed to have been incurred on behalf of the Partnership);

WHEREAS, Section 4.2(a) of the Partnership Agreement provides generally for the creation and issuance of Partnership Units with such designations, preferences and relative, participating, optional or other special rights, powers and duties, including rights, powers and duties senior to other Partnership Interests, all as shall be determined by the General Partner, without the consent of the Limited Partners, and Section 4.2(b) of the Partnership Agreement specifically contemplates the issuance of Units to the General Partner having designations, preferences and other rights, all such that the economic interests are substantially similar to the designations, preferences and other rights of shares issued by the General Partner, such as the Depositary Shares;

WHEREAS, the General Partner desires to cause the Partnership to issue additional Units of a new class and series, with the designations, preferences and relative, participating, optional or other special rights, powers and duties set forth herein; and

WHEREAS, the General Partner desires by this Amendment to so amend the Partnership Agreement as of the date first set forth above to provide for the designation and issuance of such new class and series of Units.

NOW, THEREFORE, the Partnership Agreement is hereby amended by establishing and fixing the rights, limitations and preferences of a new class and series of Units as follows:

Definitions. Capitalized terms not otherwise defined herein shall have their respective meanings set forth in the Partnership Agreement. Capitalized terms that are used in this Amendment shall have the meanings set forth below:

(a) “**Liquidation Preference**” means, with respect to the Series M Preferred Units (as defined below), \$25.00 per Series M Preferred Unit, plus the amount of any accumulated and unpaid Priority Return (as defined below) with respect to such Series M Preferred Unit, whether or not declared, minus any distributions in excess of the Priority Return that has accrued with respect to such Series M Preferred Units, to the date of payment.

(b) “**Parity Preferred Units**” means any class or series of Partnership Interests (as such term is defined in the Partnership Agreement) of the Partnership now or hereafter authorized, issued or outstanding and expressly

designated by the Partnership to rank on a parity with the Series M Preferred Units with respect to distributions and rights upon voluntary or involuntary liquidation, winding-up or dissolution of the Partnership, including the 9 1/2% Series D Cumulative Redeemable Preferred Units (the “**Series D Preferred Units**”), the 9 1/4% Series E Cumulative Redeemable Preferred Units (the “**Series E Preferred Units**”), the 8 3/4% Series F Cumulative Redeemable Preferred Units (the “**Series F Preferred Units**”), the 7.95% Series G Cumulative Redeemable Preferred Units (the “**Series G Preferred Units**”), the 7.000% Series H Cumulative Redeemable Preferred Units (the “**Series H Preferred Units**”), the 6.875% Series I Cumulative Redeemable Preferred Units (the “**Series I Preferred Units**”), the 7.50% Series J Cumulative Redeemable Preferred Units (the “**Series J Preferred Units**”), the 7.950% Series K Cumulative Redeemable Preferred Units (the “**Series K Preferred Units**”), the 7.60% Series L Cumulative Redeemable Preferred Units (the “**Series L Preferred Units**”), and the 8 7/8% Series Y Cumulative Redeemable Preferred Units (the “**Series Y Preferred Units**”). Notwithstanding the differing allocation rights set forth in Section 4 below that apply to the Series D, F, H, I, K, L and M Preferred Units (as compared to the Series E, G, J and Y Preferred Units), for purposes of this Amendment those Series D, F, H, I, K, L and M Preferred Units and any future series of preferred units that rank in parity with those series also shall be considered Parity Preferred Units to the Series E, G, J and Y Preferred Units.

(c) “**Priority Return**” means an amount equal to 7.20% per annum, of the Liquidation Preference per Series M Preferred Unit, commencing on the date of issuance of such Series M Preferred Unit, determined on the basis of a 360-day year (and twelve 30-day months), cumulative to the extent not distributed on any Series M Preferred Unit Distribution Payment Date (as defined below).

Creation of Series M Preferred Units. (a) Designation and Number. **Pursuant to Section 4.2(a) of the Partnership Agreement, a series of Partnership Units (as such term is defined in the Partnership Agreement) in the Partnership designated as the “7.20% Series M Cumulative Redeemable Preferred Units” (the “Series M Preferred Units”) is hereby established effective as of May 2, 2005. The number of Series M Preferred Units shall be 3,000,000. The Holders of Series M Preferred Units shall not have any Percentage Interest (as such term is defined in the Partnership Agreement) in the Partnership.**

(b) **Capital Contribution.** In return for the issuance to the General Partner of the Series M Preferred Units set forth on Exhibit C to this Amendment, the General Partner has contributed to the Partnership the funds raised through the General Partner’s issuance of the Depositary Shares (the General Partner’s capital contribution shall be deemed to equal the amount of the gross proceeds of that share issuance, *i.e.*, the net proceeds actually contributed, plus any underwriter’s discount or other expenses incurred, with any such discount or expense deemed to have been incurred by the General Partner on behalf of the Partnership).

(c) **Construction.** The Series M Preferred Units have been created and are being issued in conjunction with the General Partner’s issuance of the Depositary Shares relating to the General Partner’s 7.20% Cumulative Preferred Stock, Series M, and as such, the Series M Preferred Units are intended to have designations, preferences and other rights, all such that the economic interests are substantially similar to the designations, preferences and other rights of the Depositary Shares, and the terms of this Amendment shall be interpreted in a fashion consistent with this intent.

Distributions. (a) Payment of Distributions. **Subject to the rights of holders of Parity Preferred Units as to the payment of distributions, pursuant to Section 5.1 of the Partnership Agreement, holders of Series M Preferred Units shall be entitled to receive, when, as and if declared by the Partnership acting through the General Partner, the Priority Return. Such distributions shall be cumulative, shall accrue from the original date of issuance of the Series M Preferred Units and, notwithstanding Section 5.1 of the Partnership Agreement, will be payable (i) quarterly in arrears on March 31, June 30, September 30 and December 31 of each year commencing on June 30, 2005 and (ii) in the event of a redemption of Series M Preferred Units (each a “Series M Preferred Unit Distribution Payment Date”). If any date on which distributions are to be made on the Series M Preferred Units is not a Business Day (as defined below), then payment of the distribution to be made on such date will be made on the Business Day immediately preceding such date with the same force and effect as if made on such date. Distributions on the Series M Preferred Units will be made to the holders of record of the Series M Preferred Units on the relevant record dates to be fixed by the Partnership acting through the General Partner, which record dates shall in no event exceed fifteen (15) Business Days prior to the relevant Series M Preferred Unit Distribution Payment Date. Business Day shall be any day other than a**

Saturday, Sunday or day on which banking institutions in the State of New York or the State of California are authorized or obligated by law to close, or a day which is or is declared a national or a New York or California state holiday.

(b) **Prohibition on Distribution.** No distributions on Series M Preferred Units shall be authorized by the General Partner or paid or set apart for payment by the Partnership at any such time as the terms and provisions of any agreement of the Partnership or the General Partner, including any agreement relating to their indebtedness, prohibits such authorization, payment or setting apart for payment or provides that such authorization, payment or setting apart for payment would constitute a breach thereof or a default thereunder, or to the extent that such authorization or payment shall be restricted or prohibited by law.

(c) **Distributions Cumulative.** Distributions on the Series M Preferred Units will accrue whether or not the terms and provisions of any agreement of the Partnership, including any agreement relating to its indebtedness, at any time prohibit the current payment of distributions, whether or not the Partnership has earnings, whether or not there are funds legally available for the payment of such distributions and whether or not such distributions are authorized. Accrued but unpaid distributions on the Series M Preferred Units will accumulate as of the Series M Preferred Unit Distribution Payment Date on which they first become payable. Distributions on account of arrears for any past distribution periods may be declared and paid at any time, without reference to a regular Series M Preferred Unit Distribution Payment Date, to holders of record of the Series M Preferred Units on the record date fixed by the Partnership acting through the General Partner which date shall not exceed fifteen (15) Business Days prior to the payment date. Accumulated and unpaid distributions will not bear interest.

(d) **Priority as to Distributions.** Subject to the provisions of Article 13 of the Partnership Agreement:

(i) So long as any Series M Preferred Units are outstanding, no distribution of cash or other property shall be authorized, declared, paid or set apart for payment on or with respect to any class or series of Partnership Interests ranking junior as to the payment of distributions or rights upon a voluntary or involuntary liquidation, dissolution or winding-up of the Partnership to the Series M Preferred Units (collectively, “**Junior Units**”), nor shall any cash or other property be set aside for or applied to the purchase, redemption or other acquisition for consideration of any Series M Preferred Units, any Parity Preferred Units or any Junior Units, unless, in each case, all distributions accumulated on all Series M Preferred Units and all classes and series of outstanding Parity Preferred Units have been paid in full. The foregoing sentence shall not prohibit (x) distributions payable solely in Junior Units, or (y) the conversion of Junior Units or Parity Preferred Units into Partnership Interests ranking junior to the Series M Preferred Units.

(ii) So long as distributions have not been paid in full (or a sum sufficient for such full payment is not irrevocably deposited in trust for payment) upon the Series M Preferred Units, all distributions authorized and declared on the Series M Preferred Units and all classes or series of outstanding Parity Preferred Units shall be authorized and declared so that the amount of distributions authorized and declared per Series M Preferred Unit and such other classes or series of Parity Preferred Units shall in all cases bear to each other the same ratio that accrued distributions per Series M Preferred Unit and such other classes or series of Parity Preferred Units (which shall not include any accumulation in respect of unpaid distributions for prior distribution periods if such class or series of Parity Preferred Units do not have cumulative distribution rights) bear to each other.

(e) **No Further Rights.** Holders of Series M Preferred Units shall not be entitled to any distributions, whether payable in cash, other property or otherwise, in excess of the full cumulative distributions described herein.

Allocations. Section 6.1(a)(ii) of the Partnership Agreement is amended to read, in its entirety, as follows:

“ (ii) (A) Notwithstanding anything to the contrary contained in this Agreement, in any taxable year: (1) the holders of series D, F, H, I, K, L and M Preferred Units shall first be allocated an amount of gross income equal to the Priority Return distributed to such holders in such taxable year, and (2) subject to any prior allocation of Profit pursuant to the loss chargeback set forth in Section 6.1(a)(ii)(B) below, the holders of Series E, G, J and Y Preferred Units shall then be allocated an amount of Profit equal to the Priority Return distributed to such holders either in such taxable year or in prior taxable years to the extent that such distributions have not previously been matched with an allocation of Profit pursuant to this Section 6.1(a)(ii)(A)(2).

(B) After the Capital Account balances of all Partners other than holders of any series of Preferred Units have been reduced to zero, Losses of the Partnership that otherwise would be allocated so as to cause deficit Capital Account balances for those other Partners shall be allocated to the holders of the Series D, E, F, G, H, I, J, K, L, M and Y Preferred Units in proportion to the positive balances of their Capital Accounts until those Capital Account balances have been reduced to zero. If Losses have been allocated to the holders of the Series D, E, F, G, H, I, J, K, L, M and Y Preferred Units pursuant to the preceding sentence, the first subsequent Profits shall be allocated to those preferred partners so as to recoup, in reverse order, the effects of the loss allocations.

(C) Upon liquidation of the Partnership or the interest of the holders of Series D, E, F, G, H, I, J, K, L, M or Y Preferred Units in the Partnership: (1) items of gross income or deduction shall first be allocated to the holders of Series D, F, H, I, K, L and M Preferred Units in a manner such that, immediately prior to such liquidation, the Capital Account balances of such holders shall equal the amount of their Liquidation Preferences, and (2) an amount of Profit or Loss shall then be allocated to the holders of Series E, G, J and Y Preferred Units in a manner such that, immediately prior to such liquidation, the Capital Account balances of such holders shall equal the amount of their Liquidation Preferences.”

Optional Redemption. The Series M Preferred Units shall be redeemed at the same time, to the same extent, and applying, except as set forth below, similar procedures, as any redemption by the General Partner of the Depository Shares. The redemption price, payable in cash, shall equal the Liquidation Preference (the “Series M Redemption Price”). The Partnership will deliver into escrow with an escrow agent acceptable to the Partnership and the holders of the Series M Preferred Units being redeemed (the “Escrow Agent”) the Series M Redemption Price and an executed Redemption Agreement, in substantially the form attached as Exhibit A (the “Redemption Agreement”), and an Amendment to the Agreement of Limited Partnership evidencing the Redemption, in substantially the form attached as Exhibit B. The holders of the Series M Preferred Units to be redeemed will also deliver into escrow with the Escrow Agent an executed Redemption Agreement and an executed Amendment to the Agreement of Limited Partnership evidencing the redemption. Upon delivery of all of the above-described items by both parties, on the redemption date the Escrow Agent shall release the Series M Redemption Price to the holders of the Series M Preferred Units and the fully-executed Redemption Agreement and Amendment to Agreement of Limited Partnership to both parties. On and after the date of redemption, distributions will cease to accumulate on the Series M Preferred Units called for redemption, unless the Partnership defaults in the payment of the Series M Redemption Price. The Redemption Right (as such term is defined in the Partnership Agreement) given to Limited Partners (as such term is defined in the Partnership Agreement) in Section 8.6 of the Partnership Agreement shall not be available to the holders of the Series M Preferred Units and all references to Limited Partners in said Section 8.6 (and related provisions of the Partnership Agreement) shall not include holders of the Series M Preferred Units.

Voting Rights. Holders of the Series M Preferred Units will not have any voting rights or right to consent to any matter requiring the consent or approval of the Limited Partners, except as set forth in Section 14.1 of the Partnership Agreement and in this Section 6. Solely for purposes of Section 14.1 of the Partnership Agreement, each Series M Preferred Unit shall be treated as one Partnership Unit.

Transfer Restrictions. The holders of Series M Preferred Units shall be subject to all of the provisions of Section 11 of the Partnership Agreement.

No Conversion Rights. The holders of the Series M Preferred Units shall not have any rights to convert such units into shares of any other class or series of stock or into any other securities of, or interest in, the Partnership.

No Sinking Fund. No sinking fund shall be established for the retirement or redemption of Series M Preferred Units.

Exhibit A to Partnership Agreement. In order to duly reflect the issuance of the Series M Preferred Units provided for herein, the Partnership Agreement is hereby further amended pursuant to Section 12.3 of the Partnership Agreement by replacing the current form of Exhibit A to the Partnership Agreement with the form of Exhibit A that is attached to this Amendment as Exhibit C.

Inconsistent Provisions. **Nothing to the contrary contained in the Partnership Agreement shall limit any of the rights or obligations set forth in this Amendment.**

[The remainder of this page is intentionally left blank.]

IN WITNESS WHEREOF, this Amendment has been executed as of the date first above written.

PS BUSINESS PARKS, INC.

By: /s/ Edward A. Stockx
Name: Edward A. Stokx
Title: Executive Vice President and Chief Financial
Officer

EXHIBIT A

FORM OF REDEMPTION AGREEMENT

THIS REDEMPTION AGREEMENT (the "Agreement") is entered into effective as of the ___ day of ___, ___, by and between ___ (the "Retiring Partner"), and PS Business Parks, L.P., a California limited partnership (the "Partnership").

RECITALS:

WHEREAS, the Agreement of Limited Partnership of the Partnership, dated as of March 17, 1998, as amended, was amended by an Amendment to Agreement of Limited Partnership Relating to 7.20% Series M Cumulative Redeemable Preferred Units (the "Amendment"), as further amended from time to time;

WHEREAS, the Retiring Partner owns ___ of the 7.20% Series M Cumulative Redeemable Preferred Units in the Partnership (the "Series M Preferred Units"); and

WHEREAS, the Partnership desires to redeem the Series M Preferred Units of the Retiring Partner, and the Retiring Partner desires to liquidate its Series M Preferred Units (the "Redemption") pursuant to the Amendment and based on the representations and under the terms and conditions set forth below;

NOW, THEREFORE, in consideration of the mutual covenants, representations and agreements herein contained, the parties hereto, intending to be legally bound, do covenant and agree as follows:

Liquidation of Retiring Partner. In satisfaction of the terms and conditions set forth herein and in the Amendment, the Retiring Partner's Series M Preferred Units are hereby completely liquidated and the Retiring Partner immediately and automatically ceases to be a limited partner in the Partnership in exchange for the payment of the Series M Redemption Price (as defined in the Amendment and in accordance with the provisions set forth in the Amendment) and for other good and valuable consideration.

Representations of Retiring Partner. The Retiring Partner represents and warrants to the Partnership that:

(a) The Retiring Partner is duly organized and validly existing under the laws of the State of ___ and has been duly authorized by all necessary and appropriate [limited liability company] [corporate] [partnership] action to enter into this Agreement and to consummate the transactions contemplated herein. This Agreement is a valid and binding obligation of the Retiring Partner, enforceable against the Retiring Partner in accordance with its terms, except insofar as such enforceability may be affected by bankruptcy, insolvency or similar laws affecting creditor's rights generally and the availability of any particular equitable remedy.

(b) The Retiring Partner has not sold, assigned or otherwise disposed of all or any portion of the Series M Preferred Units and the Series M Preferred Units are free of any liens, security interests, encumbrances or other restrictions, whether existing of record or otherwise.

(c) The execution of this Agreement by the Retiring Partner and the performance of its obligations hereunder will not violate any contract, mortgage, indenture, or other similar restriction to which the Retiring Partner is a party or by which its assets are bound.

(d) Neither the execution nor the delivery of this Agreement nor the consummation of the transactions contemplated herein nor fulfillment of or compliance with the terms and conditions hereof (a) conflict with or will result in a breach of any of the terms, conditions or provisions of (i) the organizational and governing documents of the Retiring Partner or (ii) any agreement, order, judgment, decree, arbitration award, statute, regulation or instrument to which the Retiring Partner is a party or by which it or its assets are bound, or (b) constitutes or will constitute a breach, violation or default under any of the foregoing. No consent or approval, authorization, order,

regulation or qualification of any governmental entity or any other person is required for the execution and delivery of this Agreement and the consummation of the transactions contemplated hereby by the Retiring Partner.

Representations and Warranties of the Partnership. The Partnership represents and warrants to the Retiring Partner as follows:

(e) The Partnership is duly organized and validly existing under the laws of the State of California and has been duly authorized by all necessary and appropriate partnership action to enter into this Agreement and to consummate the transactions contemplated herein. This Agreement is a valid and binding obligation of the Partnership enforceable in accordance with its terms, except as such enforcement may be limited by bankruptcy, insolvency, reorganization, moratorium or similar laws affecting the enforcement of creditors' rights generally.

(f) The execution of this Agreement by the Partnership and the performance of its obligations hereunder will not violate any contract, mortgage, indenture, or other similar restriction to which the Partnership is a party or by which the Partnership is bound.

(g) Neither the execution nor the delivery of this Agreement nor the consummation of the transactions contemplated herein nor fulfillment of or compliance with the terms and conditions hereof (a) conflict with or will result in a breach of any of the terms, conditions or provisions of (i) the organizational and governing documents of the Partnership or (ii) any agreement, order, judgment, decree, arbitration award, statute, regulation or instrument to which the Partnership is a party or by which it or its assets are bound, or (b) constitutes or will constitute a breach, violation or default under any of the foregoing. No consent or approval, authorization, order, regulation or qualification of any governmental entity or any other person is required for the execution and delivery of this Agreement and the consummation of the transactions contemplated hereby by the Partnership.

(h) Consummation of the Redemption by the Partnership will not render the Partnership insolvent under California partnership law.

Indemnification.

(i) The Retiring Partner covenants and agrees to indemnify the Partnership and hold it harmless against and with respect to any and all damage, loss, liability, deficiency, cost and expense, including reasonable attorneys' fees, (i) resulting from any misrepresentation, breach of warranty or non-fulfillment of any agreement or covenant on the part of the Retiring Partner under this Agreement, and (ii) from any and all actions, suits, proceedings, demands, assessments, judgments, costs and legal and other expenses incident to any of the foregoing.

(j) The Partnership covenants and agrees to indemnify the Retiring Partner and hold it harmless against and with respect to any and all damage, loss, liability, deficiency, cost and expense, including reasonable attorneys' fees, (i) resulting from any misrepresentation, breach of warranty or non-fulfillment of any agreement or covenant on the part of such Partnership under this Agreement and (ii) from any and all actions, suits, proceedings, demands, assessments, judgments, costs and legal and other expenses incident to any of the foregoing.

Survival of Representations and Warranties. All representations, warranties, covenants and agreements of any of the parties hereto made in this Agreement shall survive the execution and delivery hereof, the closing hereunder, and the execution and delivery of all instruments and documents executed in connection therewith.

Integration, Interpretation and Miscellaneous. This Agreement sets forth the entire understanding of the parties hereto with respect to the subject matter herein and it shall not be changed or terminated orally. This Agreement shall be construed in accordance with the laws of the State of California. This Agreement may be executed simultaneously in two or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument. This Agreement shall be binding upon and inure to the benefit of the parties hereto and their respective heirs, personal representatives, and successors, or successors and assigns, as the case may be. The headings in this Agreement are for reference purposes only and shall not affect the meaning or interpretation of this Agreement.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement as of the day and year first above written.

RETIRING PARTNER:

By: _____
Name:
Title:

PARTNERSHIP:

PS Business Parks, L.P.
By: PS Business Parks, Inc., its General Partner

By: _____
Name:
Title:

FORM OF
AMENDMENT TO
AGREEMENT OF LIMITED PARTNERSHIP
OF
PS BUSINESS PARKS, L.P.

This Amendment to Agreement of Limited Partnership of PS Business Parks, L.P. (the “**Partnership**”), dated as of (this “**Amendment**”) is entered into by the General Partner of the Partnership, PS Business Parks, Inc., and , as a withdrawing Limited Partner of the Partnership (the “**Withdrawing Partner**”).

RECITALS:

WHEREAS, capitalized terms used herein, unless otherwise defined, have the meanings assigned to such terms in the Agreement of Limited Partnership of the Partnership entered into as of March 17, 1998, as amended (the “**Partnership Agreement**”).

WHEREAS, pursuant to the redemption by the Partnership of the 7.20% Series M Cumulative Redeemable Preferred Units pursuant to the terms and conditions set forth in that certain Redemption Agreement by and between the Partnership and the Withdrawing Partner, dated as of ___, 20___, 7.20% Series M Cumulative Redeemable Preferred Units of the Withdrawing Partner have been redeemed by the Partnership and the General Partner desires to amend the Partnership Agreement to (a) set forth a revised list of all Partners of the Partnership as of the date hereof and (b) reflect the withdrawal of the Withdrawing Partner from the Partnership.

NOW, THEREFORE, in consideration of the mutual covenants and agreements contained herein, the parties hereby agree as follows:

1. This Amendment shall be deemed effective as of the date first above written. Except as amended hereby, the Partnership Agreement shall remain in full force and effect and shall be otherwise unaffected hereby.

2. To evidence the redemption of the 7.20% Series M Cumulative Redeemable Preferred Units of the Withdrawing Partner and the withdrawal of the Withdrawing Partner as a Limited Partner of the Partnership, attached as **Schedule A** is a current list of Partners of the Partnership as of the date hereof.

3. The Withdrawing Partner is entering into this Amendment to evidence its withdrawal as a Limited Partner of the Partnership.

4. This Amendment shall be deemed to be a contract made under the laws of the State of California and for all purposes shall be governed by and construed in accordance with the laws of such state.

IN WITNESS WHEREOF, the undersigned has caused this Amendment to be executed and delivered as of the date first above written.

GENERAL PARTNER

PS Business Parks, Inc.

By: _____
Name:
Title:

WITHDRAWING LIMITED PARTNER

By: _____
Name:
Title:

PS BUSINESS PARKS, INC.
EXHIBIT 12
STATEMENT RE: COMPUTATION OF RATIO OF EARNINGS TO FIXED CHARGES
(in thousands, except ratios)

	Three Months Ended	
	March 31,	
	2005	2004
Income from continuing operations.....	\$ 14,787	\$ 11,571
Minority interest	4,373	6,344
Interest expense	282	1,266
Earnings from continuing operations available to cover fixed charges	<u>\$ 19,442</u>	<u>\$ 19,181</u>
Fixed charges (1)	\$ 282	\$ 1,266
Preferred stock dividends	9,769	7,825
Preferred partnership distributions	2,691	5,077
Combined fixed charges and preferred distributions	<u>\$ 12,742</u>	<u>\$ 14,168</u>
Ratio of earnings from continuing operations to fixed charges	<u>68.9</u>	<u>15.2</u>
Ratio of earnings from continuing operations to combined fixed charges and preferred distributions	<u>1.5</u>	<u>1.4</u>

	2004	2003	2002	2001	2000
Income from continuing operations.....	\$48,917	\$49,822	\$48,155	\$46,337	\$46,567
Minority interest	25,573	30,833	29,028	26,293	25,276
Interest expense	3,054	4,015	5,324	1,715	1,481
Earnings from continuing operations available to cover fixed charges.....	<u>\$77,544</u>	<u>\$84,670</u>	<u>\$82,507</u>	<u>\$74,345</u>	<u>\$73,324</u>
Fixed charges (1)	3,054	4,015	5,612	2,806	2,896
Preferred stock dividends	33,020	15,784	15,412	8,854	5,088
Preferred partnership distributions	20,245	19,240	17,927	14,107	12,185
Combined fixed charges and preferred distributions	<u>\$56,319</u>	<u>\$39,039</u>	<u>\$38,951</u>	<u>\$25,767</u>	<u>\$20,169</u>
Ratio of earnings from continuing operations to fixed charges	<u>25.4</u>	<u>21.1</u>	<u>14.7</u>	<u>26.5</u>	<u>25.3</u>
Ratio of earnings from continuing operations to combined fixed charges and preferred distributions.....	<u>1.4</u>	<u>2.2</u>	<u>2.1</u>	<u>2.9</u>	<u>3.6</u>

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
(Unaudited, in thousands, except ratio data)

Supplemental Disclosure of Ratio of Funds from Operations (“FFO”) to Fixed Charges:

	Three Months Ended March 31,	
	2005	2004
FFO.....	\$ 25,881	\$ 23,447
Interest expense	282	1,266
Minority interest in income – preferred units	2,691	5,077
Preferred stock distributions	9,769	7,825
FFO available to cover fixed charges	<u>\$ 38,623</u>	<u>\$ 37,615</u>
Fixed charges (2)	\$ 282	\$ 1,266
Preferred stock dividends: (3).....	9,769	5,959
Preferred partnership distributions: (3).....	2,691	4,810
Combined fixed charges and preferred distributions paid	<u>\$ 12,742</u>	<u>\$ 12,035</u>
Ratio of FFO to fixed charges	<u>137.0</u>	<u>29.7</u>
Ratio of FFO to combined fixed charges and preferred distributions paid.....	<u>3.0</u>	<u>3.1</u>

	2004	2003	2002	2001	2000
FFO (1).....	\$ 97,214	\$ 97,448	\$104,543	\$ 95,472	\$ 88,181
Interest expense	3,054	4,015	5,324	1,715	1,481
Minority interest in income – preferred units	20,245	19,240	17,927	14,107	12,185
Preferred stock distributions	33,020	15,784	15,412	8,854	5,088
FFO available to cover fixed charges	<u>\$153,533</u>	<u>\$136,487</u>	<u>\$143,206</u>	<u>\$120,148</u>	<u>\$106,935</u>
Fixed charges (2)	\$ 3,054	\$ 4,015	\$ 5,612	\$ 2,806	\$ 2,896
Preferred stock dividends: (3).....	31,154	15,784	15,412	8,854	5,088
Preferred partnership distributions: (3).....	17,106	19,240	17,927	14,107	12,185
Combined fixed charges and preferred distributions paid	<u>\$ 51,314</u>	<u>\$ 39,039</u>	<u>\$ 38,951</u>	<u>\$ 25,767</u>	<u>\$ 20,169</u>
Ratio of FFO to fixed charges	<u>50.3</u>	<u>34.0</u>	<u>25.5</u>	<u>42.8</u>	<u>36.9</u>
Ratio of FFO to combined fixed charges and preferred distributions paid	<u>3.0</u>	<u>3.5</u>	<u>3.7</u>	<u>4.7</u>	<u>5.3</u>

1. FFO has been adjusted to include the effect of impairment charges
2. Fixed charges include interest expense plus capitalized interest
3. Excludes EITF Topic D-42 distributions

RULE 13a-14(a)/15d-14(a) CERTIFICATION

I, Joseph D. Russell, Jr. certify that:

1. I have reviewed this quarterly report on Form 10-Q of PS Business Parks, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Joseph D. Russell, Jr.

Name: Joseph D. Russell, Jr.

Title: Chief Executive Officer

Date: May 9, 2005

RULE 13a-14(a)/15d-14(a) CERTIFICATION

I, Edward A. Stokx certify that:

1. I have reviewed this quarterly report on Form 10-Q of PS Business Parks, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Edward A. Stokx

Name: Edward A. Stokx

Title: Chief Financial Officer

Date: May 9, 2005

**CERTIFICATION OF CEO AND CFO PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report on Form 10-Q of PS Business Parks, Inc. (the "Company") for the period ending March 31, 2005 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), Joseph D. Russell Jr., as Chief Executive Officer of the Company, and Edward A. Stokx, as Chief Financial Officer of the Company, each hereby certifies, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Joseph D. Russell, Jr.
Name: Joseph D. Russell, Jr.
Title: Chief Executive Officer
Date: May 9, 2005

/s/ Edward A. Stokx
Name: Edward A. Stokx
Title: Chief Financial Officer
Date: May 9, 2005