

GREAT LAKES REIT
Form 10-Q
May 11, 2001

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2001

OR

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

Commission file number: 1-14307

Great Lakes REIT

(Exact name of Registrant as specified in its Charter)

Maryland 36-4238056

(State or other (IRS employer
jurisdiction identification
no.)

of incorporation
or organization)

823 Commerce Drive, Suite 300, Oak Brook, IL 60523
(Address of principal executive offices) (Zip Code)

(630) 368 - 2900

(Registrant's telephone number, including area code)

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

Number of shares of the registrant's common shares of beneficial interest, \$.01 par value per share, outstanding as of May 4, 2001: 16,731,965

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March 31, 2001

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Great Lakes REIT
Consolidated Balance Sheets (unaudited)
(in thousands, except per share data)

	March 31,
	2001

Assets	
Properties:	
Land	\$59,436
Buildings and improvements	427,263
	486,699
Less accumulated depreciation	46,937
	439,762
Cash and cash equivalents	2,043
Real estate tax escrows	317
Rents receivable	7,046
Deferred financing and leasing costs, net of accumulated amortization	7,264
Goodwill, net of accumulated amortization	1,117
Other assets	2,409
	\$459,958
Liabilities and shareholders' equity	
Bank loan payable	\$116,420
Mortgage loans payable	96,990
Bonds payable	4,270
Accounts payable and accrued liabilities	2,898

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Accrued real estate taxes	10,156
Dividends payable	6,693
Prepaid rent	2,703
Security deposits	1,669

Total liabilities	241,799

Minority interests	693

Preferred shares of beneficial interest (\$0.01 par value, 10,000 shares authorized; 1,500 9 3/4% Series A Cumulative Redeemable shares, with a \$25.00 per share Liquidation Preference, issued and outstanding in 2001 and 2000)	37,500
Common shares of beneficial interest (\$0.01 par value, 60,000 shares authorized; 18,275 shares issued in 2001 and 2000)	183
Paid-in-capital	234,968
Retained earnings (deficit)	(8,906)
Employee share loans	(20,063)
Deferred compensation	(2,542)
Treasury shares, at cost (1,543 shares in 2001 and 2000)	(23,674)

Total shareholders' equity	217,466

Total liabilities and shareholders' equity	\$459,958
	=====

The accompanying notes are an integral part of these financial statements.

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Great Lakes REIT
Consolidated Statements of Income (unaudited)
(In Thousands, except per share data)

	Three months ended March	
	2001	2000
	----	----
Revenues:		
Rental	\$19,046	\$18,
Reimbursements	5,075	5,
Parking	95	
Telecommunications	136	
Tenant service	80	
Interest	387	
Other	162	
	-----	-----
Total revenues	24,981	24,
	-----	-----
Expenses:		
Real estate taxes	3,827	3,
Other property operating	6,015	6,
General and administrative	1,287	1,
Interest	3,506	3,

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Depreciation and amortization	4,451	4,
Total expenses	19,086	18,
Income before allocation to minority interests	5,895	5,
Minority interests	14	
Net income	5,881	5,
Income allocated to preferred shareholders	914	
Net income applicable to common shares	\$4,967	\$4,
Earnings per common share - basic	\$0.30	\$0
Weighted average common shares outstanding - basic	16,573	16,
Diluted earnings per common share	\$0.30	\$0
Weighted average common shares outstanding - diluted	16,713	16,

The accompanying notes are an integral part of these financial statements.

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Great Lakes REIT
Consolidated Statement of Changes in Shareholders' Equity (unaudited)
For the Three Months Ended March 31, 2001
(Dollars in Thousands)

	2001
-----	-----
Preferred Shares	
Balance at beginning of period	\$37,500
-----	-----
Balance at end of period	37,500
Common Shares	
Balance at beginning of period	183
Exercise of share options	-
-----	-----
Balance at end of period	183
Paid-in capital	
Balance at beginning of period	234,959
Exercise of share options	9
-----	-----
Balance at end of period	234,968

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Retained earnings (deficit)	
Balance at beginning of period	(7,176)
Net income	5,881
Distributions/dividends	(7,611)

Balance at end of period	(8,906)
Employee share loans	
Balance at beginning of period	(20,096)
Repayment of share loans	42
Exercise of share options	(9)

Balance at end of period	(20,063)
Deferred compensation	
Balance at beginning of period	(2,623)
Amortization of deferred compensation	81

Balance at end of period	(2,542)
Treasury shares	
Balance at beginning of period	(23,674)

Balance at end of period	(23,674)

Total shareholders' equity	\$217,466
=====	

The accompanying notes are an integral part of these financial statements.

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Consolidated Statements of Cash Flows (unaudited)
(Dollars in Thousands)

	Three Months Ended
	2001

CASH FLOWS FROM OPERATING ACTIVITIES	
Net income	\$5,881
Adjustments to reconcile net income to cash	
flows from operating activities	
Depreciation and amortization	4,451
Other non cash items	93
Net changes in assets and liabilities:	
Rents receivable	682
Real estate tax escrows and other assets	(422)
Accounts payable, accrued expenses and other liabilities	(2,792)
Accrued real estate taxes	(728)
Payment of deferred leasing costs	(978)

Net cash provided by operating activities	6,187

CASH FLOWS FROM INVESTING ACTIVITIES	
Purchase of properties	(25,979)
Additions to buildings and improvements	(3,618)
Other investing activities	(263)

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Net cash used by investing activities	(29,860)

CASH FLOWS FROM FINANCING ACTIVITIES	
Proceeds from exercise of share options	41
Proceeds from bank and mortgage loans payable	144,419
Distributions / dividends paid	(918)
Distributions to minority interests	-
Purchase of minority interests	-
Purchase of treasury shares	-
Payment of bank and mortgage loans and bonds	(117,650)
Payment of deferred financing costs	(961)

Net cash used by financing activities	24,931

Net increase (decrease) in cash and cash equivalents	1,258
Cash and cash equivalents, beginning of year	785

Cash and cash equivalents, end of period	\$2,043
=====	
Supplemental disclosure of cash flow:	
Interest paid	\$3,950
=====	
Non cash financing transactions:	
Employee share loans	\$8
=====	
Increase in preferred dividends payable	-
=====	

The accompanying notes are an integral part of these financial statements.

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Great Lakes REIT
Notes to Consolidated Financial Statements
Dollars in thousands, except per share data
(Unaudited)

1. Basis of Presentation

Great Lakes REIT, a Maryland real estate investment trust, (the Company), was formed in 1992 to invest in income-producing real property. The principal business of the Company is the ownership, management, leasing, renovation and acquisition of suburban office properties primarily located in the Midwest. At March 31, 2001, the Company owned and operated 36 properties primarily located in suburban areas of Chicago, Detroit, Milwaukee, Denver, Cincinnati, Columbus and Minneapolis. The Company leases office space to over 500 tenants that are engaged in a variety of businesses.

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries and controlled partnership. Intercompany accounts and transactions have been eliminated in consolidation.

The accompanying consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and do not include all information and footnotes necessary for a fair presentation of financial position, results of operations and cash flows in conformity with generally accepted accounting principles. These statements should be read in conjunction with the Company's most recent year-end audited financial statements contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2000, (the 2000 10-K). In the opinion of management, the financial statements contain all adjustments (which are normal and recurring) necessary for a fair statement of financial results for the interim periods. For further information, refer to the consolidated financial statements and notes thereto included in the

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2000 10-K.

2. Segment Information

The Company has two reportable segments distinguished by property type. The property types are office, (89%) and office/service center (11%) (as measured by square feet) of the Company's overall portfolio, respectively. As of March 31, 2001, the properties were leased to more than 500 tenants, no single tenant accounted for more than 5% of the aggregate annualized base rent of the Company's portfolio and only 20 tenants individually represented more than 1% of such aggregate annualized base rent.

The Company evaluates performance and makes investment decisions in part based on net operating income, which is property revenues (rental and reimbursement income) less property operating expenses and real estate taxes. Net operating income is a widely recognized industry measure of a property's performance.

Following is a summary report of segment information for the three months ended March 31, 2001 and 2000.

	March 31,	March 31,
	2001	2000
Revenues		
Office	\$23,023	\$22,302
Office/service center	1,569	1,734
Deferred rental revenues	-	-
Interest and other	389	443
	-----	-----
Total	\$24,981	\$24,479
	=====	=====
Net operating income		
Office	\$13,730	\$12,966
Office/service center	1,021	1,112
	-----	-----
Total	\$14,751	\$14,078
	=====	=====
Depreciation and amortization		
Office	\$4,013	\$3,645
Office/service center	313	348
Other	125	134
	-----	-----
Total	\$4,451	\$4,127
	=====	=====
Interest expense		
Office	\$3,258	\$3,371
Office/service center	248	375
	-----	-----
Total	\$3,506	\$3,746
	=====	=====
Additions to properties		
Office	\$29,045	\$2,684
Office/service center	552	121
Other	-	24
	-----	-----
Total	\$29,597	\$2,829
	=====	=====

Income before allocation to

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minority interests		
Office	\$6,458	\$5,950
Office/service center	460	389
Deferred rental revenues	-	-
Interest and other income	389	443
General and administrative	(1,287)	(1,105)
Other depreciation	(125)	(134)

Income before allocation to minority interests	\$5,895	\$5,543
=====		

Following is a summary of segment assets at March 31, 2001 and December 31, 2000:

	March 31,	December 31,
	2001	2000

Assets		
Office	\$420,099	\$394,972
Office/service center	25,098	24,782
Other	14,761	11,856

Total	\$459,958	\$431,610
=====		

3. Long-Term Debt

On March 23, 2001, the Company entered into a credit agreement that provides for a new unsecured credit facility to replace the Company's existing \$150,000 unsecured credit facility scheduled to mature in April 2001. The new unsecured credit facility matures on March 23, 2004 and also has a maximum amount available of \$150,000. The interest rate on borrowings under the new credit facility is LIBOR plus 1.0% to 1.2% depending on overall Company leverage. The new credit facility contains typical financial covenants, including requirements for a minimum tangible net worth, maximum liabilities to asset values, debt service requirements, maximum liabilities to asset values, debt service coverage and net property operating income. The new credit facility also contains restrictions on, among other things, indebtedness, investments, dividends, liens, mergers and development activities.

4. Property Acquisitions

On March 1, 2001, the Company acquired 1600 Corporate Center, a 252,000 square foot multi-story office building located in Rolling Meadows, Illinois, for a contract price of \$26,000.

5. Restricted Share Grants

On June 1, 2000, the Company issued 200,000 restricted common shares to certain officers and employees. The shares vest ten years from the date of issuance provided the recipient is still employed by the Company, but may vest earlier in increments during the period ending December 31, 2002 subject to the Company achieving certain performance objectives. Upon a change in control of the Company, up to 100,000 of the restricted shares issued to certain officers of the Company vest immediately. The total fair value of the restricted shares at the date of issuance (\$3,138) is being amortized into expense over ten years on a straight-line basis, subject to adjustment when the Company determines that it is probable to achieve certain performance objectives which accelerate the full or partial vesting of the shares. The Company recorded compensation expense of \$78 for the period ended March 31, 2001.

6. Commitments and Contingencies

In 2000, the Company entered into a contract to acquire a 99,500 square foot office building currently under construction in suburban Milwaukee for a contract price of \$8,500. The total investment in this property, including tenant improvements, is expected to be \$11,700. The Company has guaranteed a letter of credit in the amount of \$2,000 to secure its obligations related to this property.

ITEM 2. Management's Discussion and Analysis of Results of Operations and Financial Condition (Dollars in thousands)

The following is a discussion and analysis of the consolidated financial condition and results of operations for the three months ended March 31, 2001. The following should be read in conjunction with the consolidated financial statements and related notes appearing elsewhere herein and

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the consolidated financial statements and related notes contained in the 2000 10-K.

Overview

The principal business of the Company is the ownership, management, leasing, renovation, and acquisition of suburban office properties located primarily in the Midwest. At March 31, 2001, the Company owned and operated 36 properties primarily located in suburban areas of Chicago, Detroit, Milwaukee, Columbus, Minneapolis, Denver and Cincinnati. The Company leases space to over 500 tenants that are engaged in a variety of businesses.

Three months ended March 31, 2001 compared to three months ended March 31, 2000.

In analyzing the operating results for the quarter ended March 31, 2001, the changes in rental and reimbursement income, real estate taxes, and other property operating expenses from 2000 are due principally to: (i) the addition of a full year's operating results in 2001 of properties acquired in 2000 compared to the partial year's operating results from the dates of their respective acquisitions in 2000, (ii) the addition of operating results of the property acquired in 2001 from the date of its acquisition (iii) the effect of property dispositions in 2000 and (iv) improved operations of properties during 2001 compared to 2000.

	Rental income	Reimbursement income	Real estate taxes	Property operating expenses
Increase due to inclusion of results of properties acquired in 2000	306	256	114	154
Increase due to 2001 acquisition	225	180	115	41
Effect of property dispositions in 2000	(363)	(29)	(50)	(34)
Increase (decrease) in 2001 as compared to 2000	327	(583)	(274)	(182)

Total	495	(176)	(95)	(21)
	=====			

Telecommunications income increased by \$37 during the quarter ended March 31, 2001 as compared to 2000 as the Company signed additional license agreements during 2001.

Tenant service income increased to \$80 in the quarter ended March 31, 2001 as a result of the Company's initiative to increase this income, which commenced in mid-2000.

Interest income increased by \$67 during the quarter ended March 31, 2001, as compared to 2000 due to higher employee share loans receivable in 2001.

General and administrative expenses increased by \$182 during the quarter ended March 31, 2001 as compared to 2000 due to the amortization expense associated with the restricted share program (\$79), increases in certain insurance costs (\$38) and increases caused by timing of the payment of certain audit and legal fees (\$55).

Interest expense declined by \$240 during the quarter ended March 31, 2001 as compared to 2000 as the Company had lower average amounts outstanding under its unsecured credit facility as well as lower interest rates on its unsecured credit facility in 2001.

Depreciation and amortization expenses increased by \$324 during the quarter ended March 31, 2001 as compared to 2000 because the Company had a gross book value of depreciable assets of \$427,263 at March 31, 2001 as compared to \$412,755 at March 31, 2000.

Liquidity and Capital Resources

The Company expects to meet its short-term liquidity requirements principally through its working capital and net cash provided by operating activities. The Company considers its cash provided by operating activities to be adequate to meet operating requirements and to fund the payment of dividends in order to comply with certain federal income tax requirements applicable to real estate investment trusts (REITs).

On March 23, 2001, the Company entered into a credit agreement that provides for a new unsecured credit facility to replace the Company's \$150,000 unsecured credit facility that was scheduled to mature in April 2001. The new unsecured credit facility matures on March 23, 2004 and also has a maximum amount available of \$150,000. Borrowings under the new credit facility bear interest at LIBOR plus 1.0% to 1.2%, depending on overall Company leverage. The new credit facility contains typical financial covenants, including requirements for a minimum

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tangible net worth, maximum liabilities to asset values, debt service coverage and net property operating income. The new credit facility also contains restrictions on, among other things, indebtedness, investments, dividends, liens, mergers and development activities.

The Company expects to meet its liquidity requirements for property acquisitions and significant capital improvements through property dispositions and additional borrowings under its new unsecured credit facility. The Company had \$33,580 available for future borrowings under this credit facility at March 31, 2001.

The Company expects to meet its long-term liquidity requirements (such as scheduled mortgage debt maturities, property acquisitions and significant capital improvements) through long-term collateralized and uncollateralized borrowings, the issuance of debt or equity securities and targeted property dispositions.

The Company entered into a contract in 2000 to acquire a 99,500 square foot office building currently under construction in suburban Milwaukee for a contract price of \$8,500. The total investment in this property, including tenant improvements, is expected to be \$11,700. The Company expects to acquire this property in early 2002. The Company has guaranteed a letter of credit in the amount of \$2,000 to secure its obligations related to this property.

In January 2001, the Company entered into an option agreement under which the Company may elect to acquire approximately 23 acres of land in Englewood, Colorado for a purchase price of approximately \$8,500. The Company has the option to acquire the land in two phases in July 2001 and July 2002. Under current zoning, the Company may construct or cause to be constructed up to 400,000 square feet of office space on this site. The Company has not determined if it will proceed with the land purchase.

Forward-Looking Statements

Statements regarding the Company's liquidity requirements and certain other statements in this report are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. The words believe, expect, anticipate and similar expressions identify forward-looking statements. Although the Company believes that the expectations reflected in these forward-looking statements are based on reasonable assumptions, there can be no assurance that such expectations will be met. Various factors could cause actual results to differ materially from the Company's expectations, including the following: changes in general economic conditions and the failure of the economy to recover timely from the current downturn; changes in the economic conditions affecting industries in which the Company's principal tenants operate; the Company's ability to timely lease or re-lease space at current or anticipated rents; changes in operating costs, including utility costs and real estate taxes; the Company's ability to attract and retain high-quality personnel at a reasonable cost in a highly competitive labor environment; the Company's ability to complete current and future development projects on schedule and on budget; and the demand for office space in the markets in which the Company has a presence. Many of these factors are beyond the Company's ability to control or predict. Forward-looking statements are not guarantees of performance. For forward-looking statements made in this report, the Company claims the protection of the safe harbor for forward-looking statements made in the Private Securities Litigation Reform Act of 1995. The Company assumes no obligation to update or supplement forward-looking statements.

ITEM 3. MARKET RISK (Dollars in thousands)

The Company's interest income is sensitive to changes in the general levels of U.S. short-term interest rates.

The Company's interest expense is sensitive to changes in the general level of U.S. short-term and long-term interest rates as the Company has outstanding indebtedness at fixed and variable rates.

The Company's variable rate debt bears interest at LIBOR plus 1% to 1.2% per annum depending on overall Company leverage. Increases in LIBOR rates would increase the Company's interest expense and reduce its cash flow. Conversely, declines in LIBOR rates would decrease its interest expense and increase its cash flow. In 1999, the Company entered into an interest rate cap agreement whereby the LIBOR rate on \$50,000 of its variable rate debt is limited to a maximum of 6% until June 2001, thereby limiting the interest rate on that portion of the Company's unsecured credit facility to 7.0% to 7.2%.

At March 31, 2001, the Company had \$96,990 of fixed rate debt outstanding at an average rate of 6.97%. If the general level of interest rates in the United States were to fall, the Company would not likely have the opportunity to refinance this fixed rate debt at lower interest rates due to prepayment restrictions and penalties on its fixed rate debt.

In general, the Company believes long-term fixed rate debt is preferable as a financing vehicle for its operations due to the long-term fixed contractual rental income the Company receives from its tenants. As a result, 45% of the Company's long-term debt outstanding at March 31, 2001 is at fixed rates. The Company may, as market conditions warrant, enter into additional fixed rate long-term debt instruments on either a secured or unsecured basis.

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A tabular presentation of interest rate sensitivity is as follows:

	Interest Rate Sensitivity				
	Principal Amount by Expected Maturity				
	Average Interest Rate				
	2001 (1)	2002	2003	2004	2005
Liabilities:					
Fixed Rate					
Mortgage loans payable	\$2,180	\$2,831	\$13,882	\$5,440	\$3,048
Average interest rate	6.97%	6.97%	7.06%	7.86%	6.86%
Fixed Rate					
Bank loan payable				\$50,000	
Average interest rate (2)					
Variable Rate					
Bank loan payable				\$66,420	
Average interest rate (3)					
Bonds payable	\$310	\$340	\$375	\$415	\$460
Average interest rate	(4)	(4)	(4)	(4)	(4)

1. For the period April 1, 2001 to December 31, 2001.
2. The maximum interest rate on this loan is 7.2%. The average interest rate for the period ended March 31, 2001 was 6.95 %.
3. As of March 31, 2001, the interest rate on this debt was LIBOR + 1.1%. The average interest rate for the period ended March 31, 2001 was 7.15%.
4. The interest rate on the bonds payable is reset weekly. After factoring in credit enhancement costs for the bonds, the average interest rate for the period ended March 31, 2001 was 4.8%.

Part II. Other Information

Item 6. Exhibits and Reports on Form 8-K

a. Exhibits

The following exhibits are attached hereto:

<u>Exhibit</u>	<u>Description of Document</u>
<u>Number</u>	

b. Reports on Form 8-K:

None

SIGNATURES

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

Great Lakes REIT.
(Registrant)

Date: May 11, 2001

/s/ James Hicks
Chief Financial Officer and

SIGNATURES

(Principal Financial and
Accounting Officer)