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KOGER EQUITY INC
Form 10-K
March 27, 2002

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K

X ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
----- EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2001 OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934

For the transition period from ----- to -----

Commission File Number 1-9997
KOGER EQUITY, INC.
(Exact name of Registrant as specified in its Charter)

FLORIDA 59-2898045
(State or other jurisdiction (I.R.S. Employer Identification No.)
of incorporation or organization)
433 Plaza Real, Suite 335
Boca Raton, Florida 33432
(Address of principal executive offices) (Zip code)

Registrant's telephone number, including area code: (561) 395-9666
Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Exchange on Which Registered
1. Common Stock, Par Value \$.01	New York Stock Exchange
2. Common Stock Purchase Rights	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

Title of Class
NONE

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

Yes X No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. X

The aggregate market value of the voting stock held by non-affiliates of the registrant on March 1, 2002 was approximately \$369,853,000.

The number of shares of registrant's Common Stock outstanding on March 1, 2002 was 21,134,458.

Documents Incorporated by Reference

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The Company's Proxy Statement to be filed pursuant to Regulation 14A under the Securities Act of 1934 for the 2002 Annual Meeting of Shareholders is incorporated by reference in Part III of this report.

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PART I

Item 1. BUSINESS

General

Koger Equity, Inc. ("KE") is a self-administered and self-managed equity real estate investment trust (a "REIT") which develops, owns, operates and manages suburban office buildings (the "Office Buildings") primarily located in 12 office centers (each a "Koger Center") located in eight metropolitan areas throughout the southeastern United States. As of December 31, 2001, KE owns 120 Office Buildings, of which 118 are in Koger Centers and two are outside Koger Centers but in metropolitan areas where Koger Centers are located. Koger-Vanguard Partners, L.P. ("KVP") is a limited partnership, for which KE is the general partner, which owns suburban office buildings located in a Koger Center. As of December 31, 2001, KVP owns 13 Office Buildings. The Office Buildings contain approximately 6.9 million rentable square feet and were on average 90 percent leased as of December 31, 2001. While KE expects to continue the development of suburban office properties for its own account, it may from time to time acquire developed properties compatible with its properties in other markets primarily in the Southeast if such acquisitions can be made on terms favorable to KE. During December 2001, KE sold 75 suburban office buildings and one retail center, containing more than 3.9 million rentable square feet, located throughout San Antonio and Austin, Texas; Greensboro and Charlotte, North Carolina; Greenville, South Carolina; and Birmingham, Alabama. These properties were sold to AP-Knight, LP ("AP-Knight"), an affiliate of Apollo Real Estate Investment Fund ("Apollo").

KE owns approximately 78 acres of unencumbered land held for development and approximately one acre of unencumbered land held for sale. A majority of the land held for development adjoins Office Buildings in four Koger Centers, which have infrastructure, including roads and utilities, in place. The remaining land held for development adjoins properties which were sold during 2001. KE intends over time to develop and construct office buildings using this land and to acquire additional land for development. In addition, KE provides leasing, management and other customary tenant-related services for the Koger Centers.

In addition to managing its own properties, KE provides property and asset management services through its wholly-owned subsidiaries, Southeast Properties Holding Corporation ("Southeast"), Koger Real Estate Services, Inc. ("KRES") and Koger Realty Services, Inc. ("KRSI") for office buildings owned by unaffiliated parties (KE, KVP, Southeast, KRES and KRSI are hereafter referred to as the "Company"). Through August 2001, KRSI provided property management services to Koala Realty Holding Company, Inc. ("Koala") for 55 office properties. On December 12, 2001, KRSI began providing property management services to the properties sold to AP-Knight. The Company currently provides asset management services to Crocker Realty Trust for office properties containing approximately 4.6 million square feet.

KE operates in a manner so as to qualify as a REIT under the provisions of the Internal Revenue Code of 1986, as amended (the "Code"). As a REIT, the Company will not, with certain limited exceptions, be taxed at the corporate level on taxable income distributed to its shareholders on a current basis. The Company distributes at least 90 percent of its annual REIT taxable income (which

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term is used herein as defined and modified in the Code) to its shareholders. To qualify as a REIT, a corporation must meet certain substantive tests: (a) at least 95 percent of its gross income must be derived from certain passive and real estate sources; (b) at least 75 percent of its gross income must be derived from certain real estate sources; (c) at the close of each calendar quarter, it must meet certain tests designed to ensure that its assets consist principally (at least 75 percent by value) of real estate assets, cash and cash equivalents and that its holdings of securities are adequately diversified; (d) each year, it must distribute at least 90 percent of its REIT taxable income; and (e) at no time during the second half of any calendar year may the Company be "closely held" (i.e., have more than 50 percent in value of its outstanding stock owned, directly, indirectly or constructively, by not more than five individuals). The constructive ownership rules, among other things, treat the shareholders of a corporation as owning proportionately any stock in another corporation owned by the first corporation. Management fee revenue does not qualify as real estate or passive income for purposes of determining whether the Company has met the REIT requirements that at least 95 percent of the Company's gross income be derived from certain real estate and passive sources and that at least 75 percent of its gross income be derived from certain real estate sources. Accordingly, in the event the Company derives income in excess of five percent from management and other "non-real estate" and "non-passive" activities, the Company would no longer qualify as a REIT for federal income tax purposes and would be required to pay federal income taxes as a business corporation. The income earned by KRSI is not included in determining KE's qualification as a REIT.

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Two major governmental tenants, when all of their respective departments and agencies which lease space in the Company's buildings are combined, lease more than 10 percent of the rentable area of the Company's buildings and contribute more than 10 percent of the Company's annualized rentals as of December 31, 2001. At that date, the United States of America leased 13 percent of the Company's rentable square feet and accounted for an aggregate of 15.7 percent of the Company's annualized rents. In addition, the State of Florida leased 11.1 percent of the Company's rentable square feet and accounted for 13.5 percent of the Company's annualized rents. Some of the Company's principal tenants are the United States of America, the State of Florida, Blue Cross and Blue Shield of Florida, Landstar System Holdings, Wellspring Resources, Siemens Westinghouse, Zurich Insurance, General Electric, Hoechst Celanese Corp. and Hanover Insurance. Governmental tenants (including the State of Florida and the United States of America), which account for 27.3 percent of the Company's leased space, may be subject to budget reductions in times of recession and governmental austerity measures. There can be no assurance that governmental appropriations for rents may not be reduced. Additionally, certain private-sector tenants, which have contributed to the Company's rent stream, may reduce their current demands, or curtail their future need, for additional office space.

Competition

The Company competes in the leasing of office space with a considerable number of other realty concerns, including local, regional and national, some of which have greater resources than the Company. Through its ownership and management of suburban office parks, the Company seeks to attract tenants by offering office space convenient to residential areas. In recent years local, regional and national concerns have built competing office parks and single buildings in suburban areas in which the Company's Office Buildings are located. In addition, the Company competes for tenants with large high-rise office buildings generally located in the downtown business districts of these metropolitan areas. Although competition from other lessors of office space

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varies from city to city, the Company has been able to attain and maintain what it considers satisfactory occupancy levels at satisfactory rental rates.

Investment Policies

The Company is currently in a position to capitalize on some of its strengths, such as the value of its franchise in the suburban office park market and its operating systems, development expertise, acquisition expertise and unimproved land available for development. The Company intends to continue to develop and construct office buildings primarily using its existing inventory of 78 acres of land held for development, most of which is partially or wholly improved with streets and/or utilities and is located in various metropolitan areas where the Company currently operates or manages suburban office parks. The Company may also acquire existing office buildings or additional land for development in other markets primarily in the Southeast that the Company considers favorable. Although all of the Company's properties are located in the Southeast, management does not consider that the Company's development and acquisitions activities are limited to any particular area. The Company may also sell Office Buildings or Koger Centers located in certain markets. In addition, the Company has adopted a plan to repurchase up to 2.65 million shares of its common stock.

The investment policies of the Company may be changed by its directors at any time without notice to, or a vote of, shareholders. Although the Company has no fixed policy which limits the percentage of its assets which may be invested in any one type of investment or the geographic areas in which the Company may acquire properties, the Company intends to continue to operate so as to qualify for tax treatment as a REIT. The Company may in the future invest in other types of office buildings, apartment buildings, shopping centers, and other properties. The Company also may invest in the securities (including mortgages) of companies primarily engaged in real estate activities; however, it does not intend to become an investment company regulated under the Investment Company Act of 1940.

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For the year ended December 31, 2001, all of the Company's rental revenues were derived from buildings purchased or constructed by the Company. The Company's 2001 interest revenues were derived from temporary cash investments and notes receivable from current and former employees.

Employees

The Company has a combined financial, administrative, leasing, and center maintenance staff of 180 employees. A resident manager is responsible for the leasing and operations of all buildings in a Koger Center or metropolitan area. The Company has approximately 63 employees who perform maintenance activities.

Item 2. PROPERTIES

General

As of December 31, 2001, the Company owned 120 Office Buildings located in the eight metropolitan areas of Jacksonville, Orlando, St. Petersburg, and Tallahassee, Florida; Atlanta, Georgia; Charlotte, North Carolina; Memphis, Tennessee; and Richmond, Virginia. The Koger Centers have been developed in campus-like settings with extensive landscaping and ample tenant parking. The Office Buildings are generally one to five-story structures of contemporary design and constructed of masonry, concrete and steel, with facings of brick,

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concrete and glass. The Koger Centers are generally located with easy access, via expressways, to the central business district and to shopping and residential areas in the respective communities. The properties are well maintained and adequately covered by insurance.

Leases on the Office Buildings vary between net leases (under which the tenant pays some operating expenses, such as utilities, insurance and repairs) and gross leases (under which the Company pays all such items). Most leases are on a gross basis and are for terms generally ranging from three to five years. In some instances, such as when a tenant rents the entire building, leases are for terms of up to 20 years. As of December 31, 2001, the Office Buildings were on average 90 percent leased and the average annual rent per rentable square foot leased was \$16.71. The buildings are occupied by numerous tenants (approximately 896 leases), many of whom lease relatively small amounts of space, conducting a broad range of commercial activities.

New leases and renewals of existing leases are negotiated at the current market rate at the date of execution. The Company endeavors to include escalation provisions in all of its gross leases. As of December 31, 2001, approximately four percent of the Company's annualized gross rental revenues were derived from existing leases containing rental escalation provisions based upon changes in the Consumer Price Index (some of which contain maximum rates of increases); approximately 93 percent of such revenues were derived from leases containing escalation provisions based upon fixed steps or real estate tax and operating expense increases; and approximately three percent of such revenues were derived from leases without escalation provisions. Some of the Company's leases contain options which allow the lessee to renew for varying periods, generally at the same rental rate and subject, in most instances, to Consumer Price Index escalation provisions.

The Company owns approximately 85 acres of unimproved land (78 acres held for development, one acre held for sale and six acres not suitable for development) located in the metropolitan areas of Birmingham, Alabama; Orlando and St. Petersburg, Florida; Atlanta, Georgia; Charlotte and Greensboro, North Carolina; and Columbia and Greenville, South Carolina. Each of these parcels of land has been partially or wholly developed with streets and/or utilities.

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Property Location and Other Information

The following table sets forth information relating to the properties owned by the Company as of December 31, 2001.

Koger Center/Location -----	Number of Buildings -----	Average Age of Buildings (In Years) (1) -----	Rentable Sq. Ft. -----
Atlanta Chamblee	21	19	1,110,903
Atlanta Gwinnett	3	5	260,484
Atlanta Perimeter	1	16	176,503
Birmingham Colonnade			

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Charlotte Carmel			
Charlotte University	2	3	182,852
Charlotte Vanguard	13	18	525,732
Columbia Spring Valley			
Greensboro Wendover			
Greenville Park Central			
Jacksonville Baymeadows	7	9	749,790
Jacksonville JTB	4	2	416,773
Memphis Germantown	6	8	527,180
Orlando Central	21	30	616,905
Orlando Lake Mary	2	3	303,481
Orlando University	5	7	380,117
Richmond Paragon	1	16	145,008
St. Petersburg	15	18	669,807
Tallahassee	19	19	833,372
	-----		-----
Total	120		6,898,907
	====		=====
Average		14	
		==	

- (1) The age of each building was weighted by the rentable square feet for such building to determine the weighted average age of (a) the buildings in each Koger Center or location and (b) all buildings owned by the Company.

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Percent Leased and Average Rental Rates

The following table sets forth, with respect to each Koger Center or location, the number of buildings, number of leases, rentable square feet, percent leased, and the average annual rent per rentable square foot leased, in each case as of December 31, 2001.

Koger Center/Location	Number of Buildings	Number of Leases	Rentable Square Feet	Perce Leas
-----	-----	-----	-----	-----
Atlanta Chamblee	21	137	1,110,903	
Atlanta Gwinnett (3)	3	46	260,484	
Atlanta Perimeter	1	15	176,503	
Charlotte University	2	20	182,852	
Charlotte Vanguard	13	69	525,732	
Jacksonville Baymeadows	7	38	749,790	
Jacksonville JTB	4	7	416,773	
Memphis Germantown	6	87	527,180	
Orlando Central	21	147	616,905	
Orlando Lake Mary	2	21	303,481	
Orlando University (3)	5	63	380,117	
Richmond Paragon	1	29	145,008	
St. Petersburg (3)	15	126	669,807	
Tallahassee	19	91	833,372	

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Total	----- 120 ===	----- 896 =====	----- 6,898,907 =====
Weighted Average - Total Company			
Weighted Average - Operational Buildings			
Weighted Average - Buildings in Lease-up			

- (1) The percent leased rates have been calculated by dividing total rentable square feet leased in a building by rentable square feet in such building.
- (2) Rental rates are computed by dividing (a) total annualized base rents (which excludes expense pass-throughs and reimbursements) for a Koger Center or location as of December 31, 2001 by (b) the rentable square feet applicable to such total annualized base rents.
- (3) Includes a building which is currently in the lease-up period.
- (4) Includes the effect of net leases where tenants pay certain operating costs in addition to base rent.

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Lease Expirations on the Company's Properties

The following schedule sets forth with respect to all of the Office Buildings (a) the number of leases which will expire in calendar years 2002 through 2010, (b) the total rentable area in square feet covered by such leases, (c) the percentage of total rentable square feet leased represented by such leases, (d) the average annual rent per square foot for such leases, (e) the current annualized base rents represented by such leases, and (f) the percentage of gross annualized base rents contributed by such leases. This information is based on the buildings owned by the Company on December 31, 2001 and on the terms of leases in effect as of December 31, 2001, on the basis of then existing base rentals, and without regard to the exercise of options to renew. Furthermore, the information below does not reflect that some leases have provisions for early termination for various reasons, including, in the case of government entities, lack of budget appropriations. Leases were renewed on approximately 66 percent, 61 percent and 66 percent of the Company's square feet, which were scheduled to expire during 2001, 2000 and 1999, respectively.

Period	Number of Leases Expiring	Number of Square Feet Expiring	Percentage of Total Square Feet Leased Represented by Expiring Leases	Average Annual Rent per Square Foot Under Expiring Leases	Total Annualized Rents Under Expiring
-----	-----	-----	-----	-----	-----
2002	290	1,264,098	20.4%	\$17.30	\$21,871
2003	205	1,386,694	22.3%	15.50	21,488

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2004	197	820,821	13.2%	16.34	13,412
2005	91	603,969	9.7%	17.87	10,794
2006	64	553,616	8.9%	18.09	10,015
2007	15	479,384	7.7%	16.39	7,857
2008	16	346,630	5.6%	18.06	6,260
2009	8	224,516	3.6%	19.78	4,440
2010	3	116,495	1.9%	17.10	1,991
Other	7	412,578	6.7%	13.60	5,610
	-----	-----	-----		-----
Total	896	6,208,801	100.0%	\$16.71	\$103,741
	=====	=====	=====	=====	=====

Building Improvements, Tenant Improvements and Deferred Tenant Costs on the Company's Properties

The following table sets forth certain information with respect to the building improvements made, and tenant improvement costs and deferred tenant costs (leasing commissions and tenant relocation costs) incurred, by the Company during the three years ended December 31, 2001. The information set forth below is not necessarily indicative of future expenditures for these items.

Year	Building Improvements		Tenant Improvements		Deferred
	Total	Per Average Usable Sq. Ft. Owned	Total	Per Average Usable Sq. Ft. Owned	
1999 (1)	\$4,545,000	\$0.50	\$13,204,000	\$1.46	\$1,736,000
2000 (2)	4,005,000	0.48	8,362,000	1.00	1,711,000
2001 (3)	4,829,000	0.58	6,666,000	0.80	1,381,000

(1) Excludes the 14 buildings for which construction was completed during 1997, 1998 and 1999.

(2) Excludes the 18 buildings for which construction was completed during 1998, 1999 and 2000.

(3) Excludes the 13 buildings for which construction was completed during 1999, 2000 and 2001.

Fixed Rate Indebtedness on the Company's Properties

The following table sets forth with respect to each Koger Center or location the principal amount (dollars in thousands) of, and the weighted

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average interest rate on, the indebtedness of the Company having a fixed interest rate and encumbering the Company's properties in such Koger Center or location as of December 31, 2001.

Koger Center/Location	Mortgage Loan Balance	Weighted Average Interest Rate
Atlanta Chamblee	\$ 0	-
Atlanta Gwinnett	10,693	8.26%
Atlanta Perimeter	7,201	8.26%
Charlotte University	0	-
Charlotte Vanguard	19,468	8.20%
Jacksonville Baymeadows	33,733	7.86%
Jacksonville JTB	17,414	8.26%
Memphis Germantown	24,269	7.84%
Orlando Central	26,335	8.26%
Orlando Lake Mary	12,778	8.26%
Orlando University	20,657	7.25%
Richmond Paragon	7,903	8.00%
St. Petersburg	27,779	8.26%
Tallahassee	38,909	8.10%
Total	\$247,139	8.04%

The outstanding principal amount of the mortgage loan with Northwestern Mutual Life Insurance Company has been allocated based upon the square footage of the collateral in the applicable Koger Center or location. For additional information on these loans see Note 3, "Mortgages and Loans Payable" of the Notes to Consolidated Financial Statements.

Indebtedness with Variable Interest Rates

As of December 31, 2001, the Company had a \$125 million secured revolving credit facility and a term loan with variable interest rates and encumbering certain of the Company's properties. The following table sets forth historical information with respect to indebtedness having variable interest rates (dollars in thousands):

Year Ended December 31	Balance at End of Period	Weighted Average Int. Rate at End of Period	Maximum Amount Outstanding	Approximate Average Amount Outstanding
2001	\$ 1,544	7.9%	\$101,577	\$90,009
2000	90,000	8.1%	123,500	96,262
1999	94,000	8.0%	128,000	95,277

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None.

Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS
None.

PART II

Item 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

The Company's common stock is listed on the New York Stock Exchange under the ticker symbol KE. The high and low closing sales prices for the periods indicated in the table below were:

Quarter Ended	2001		Years 2000		H
	High	Low	High	Low	
March 31	\$15.97	\$13.35	\$17.9375	\$15.5000	\$17
June 30	16.60	14.07	18.8750	16.5625	18
September 30	17.51	15.95	17.4375	16.6250	18
December 31	18.10	16.30	16.9375	15.0625	16

Any dividend paid in respect of the Company's common stock during the last quarter of each year will, if necessary, be adjusted to satisfy the REIT qualification requirement that at least 90 percent of the Company's REIT taxable income for such taxable year be distributed. The Company's secured revolving credit facility requires the Company to maintain certain financial ratios, which includes a limitation on dividends. However, this covenant does not restrict the Company from paying the dividends required to maintain its qualification as a REIT.

Set forth below are the dividends per share paid during the three years ended December 31, 2001.

Quarter Ended	Years		
	2001	2000	1999
March 31	\$.35	\$.35	\$.30
June 30	.35	.35	.30
September 30	.35	.35	.35
December 31	.35	.35	.35

On January 15, 2002, the Company paid a capital gain distribution in the form of a special dividend of \$1.74 per share to shareholders of record on December 28, 2001. On February 7, 2002, the Company paid a quarterly dividend of \$0.35 per share to shareholders of record on December 31, 2001. In addition, the Company's Board of Directors has declared a quarterly dividend of \$0.35 per share payable on May 2, 2002, to shareholders of record on March 31, 2002.

On March 1, 2002, there were approximately 1,228 shareholders of record and

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the closing price of the Company's common stock on the New York Stock Exchange was \$17.50.

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Item 6. SELECTED FINANCIAL DATA

The following selected financial data should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the Consolidated Financial Statements (as defined below) and the notes thereto.

Income Information	2001	(In thousands except per 2000	1999
	-----	-----	-----
Rental revenues and other rental services	\$165,623	\$164,733	\$156,1
Interest revenues	776	703	4
Total revenues	170,560	167,874	160,0
Property operations expense	61,608	61,868	60,5
Depreciation and amortization	36,007	35,133	32,3
Mortgage and loan interest	25,204	27,268	21,8
General and administrative expense	8,412	20,217	8,6
Net income	73,223	27,153	36,5
Earnings per share - diluted	2.75	1.01	1.
Dividends declared per common share (1)	3.14	1.40	1.
Weighted average shares outstanding - diluted	26,610	26,962	27,0
 Balance Sheet Information			
Operating properties (before depreciation)	\$663,286	\$946,780	\$927,5
Undeveloped land	13,855	13,975	17,1
Total assets	690,585	851,022	885,7
Mortgages and loans payable	248,683	343,287	351,5
Total shareholders' equity	354,542	448,493	467,8
 Other Information			
Funds from operations (2)	\$ 69,681	\$ 56,107	\$ 65,0
Income before interest, income taxes, depreciation and amortization	\$135,118	\$ 89,533	\$ 90,9
Number of buildings (at end of period)	120	194	2
Percent leased (at end of period)	90%	90%	9

(1) Includes a capital gain distribution in the form of a special dividend of \$1.74 per share.

(2) The Company believes that Funds from Operations is one measure of the performance of an equity REIT. Funds from Operations should not be considered as an alternative to net income as an indication of the Company's financial performance or to cash flow from operating activities (determined in accordance with GAAP) as a measure of the Company's

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liquidity, nor is it necessarily indicative of sufficient cash flow to fund all of the Company's needs. Funds from Operations is calculated as follows (in thousands):

	2001	2000	199
	-----	-----	-----
Net income	\$73,223	\$27,153	\$36
Depreciation - real estate	32,261	31,720	28
Amortization - deferred tenant costs	2,172	1,923	2
Amortization - goodwill	170	170	
Minority interest	1,044	1,156	1
Gain on sale or disposition of operating properties	(39,189)	(5,963)	(3
Gain on sale or disposition of non-operating assets		(52)	
Recovery of loss on land held for sale			
Loss on early retirement of debt			
	-----	-----	-----
Funds from Operations	\$69,681	\$56,107	\$65
	=====	=====	=====

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Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with the selected financial data and the consolidated financial statements (the "Consolidated Financial Statements") appearing elsewhere in this report. Historical results and percentage relationships in the Consolidated Financial Statements, including trends which might appear, should not be taken as indicative of future operations or financial position. The Consolidated Financial Statements include the accounts of KE, Southeast, KRES, KRSI and KVP (collectively, the "Company").

GENERAL

The Company has prepared, and is responsible for, the accompanying Consolidated Financial Statements and the related consolidated financial information included in this report. Such Consolidated Financial Statements were prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") and include amounts determined using management's best judgments and estimates of the expected effects of events and transactions that are being accounted for currently.

The Company's independent auditors have audited the accompanying Consolidated Financial Statements. The objective of their audit, conducted in accordance with auditing standards generally accepted in the United States of America, was to express an opinion on the fairness of presentation, in all material respects, of the Company's consolidated financial position, results of operations, and cash flows in conformity with GAAP. They evaluated the Company's internal control structure to the extent considered necessary by them to determine the audit procedures required to support their report on the Consolidated Financial Statements and not to provide assurance on such structure.

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The Company maintains accounting and other control systems which management believes provide reasonable assurance that the Company's assets are safeguarded and that the Company's books and records reflect the authorized transactions of the Company, although there are inherent limitations in any internal control structure, as well as cost versus benefit considerations. The Audit Committee of the Company's Board of Directors, which is composed exclusively of directors who are not officers of the Company, directs matters relating to audit functions, annually appoints the auditors subject to ratification of the Company's Board of Directors, reviews the auditors' independence, reviews the scope and results of the annual audit, and periodically reviews the adequacy of the Company's internal control structure with its external auditors, its internal auditors and its senior management.

RESULTS OF OPERATIONS

Rental Revenues. Rental revenues increased \$848,000 or 0.5 percent from the year ended December 31, 2000 to the year ended December 31, 2001. This increase resulted primarily from (i) the increase in the Company's average rental rate and (ii) increases in rental revenues (\$7,308,000) from seven buildings constructed by the Company. The effect of these increases was partially offset by (i) the reduction of rental revenues (\$5,949,000) caused by the sale of two office parks during 2000 and 75 office buildings and one retail center on December 12, 2001 (the "2001 Property Sale") and (ii) the decline in occupancy in the stabilized properties owned at December 31, 2001. For 2000, rental revenues increased \$8,365,000 or 5.4 percent from the year ended December 31, 1999. This increase resulted primarily from (i) the increase in the Company's average rental rate and (ii) increases in rental revenues (\$15,364,000) from properties acquired and construction completed during 1999 and 2000. The effect of these increases was partially offset by the reduction of rental revenues (\$13,497,000) caused by the sale of two office parks during 1999 and two office parks during 2000. As of December 31, 2001, the Company's buildings were on average 90 percent leased. As of December 31, 2000 and 1999, the buildings owned by the Company were on average 90 and 93 percent leased, respectively.

Management Fee Revenues. For 2001, management fee revenues increased \$2,287,000, as compared to 2000. This increase was due primarily to (i) the merger of Koger Realty Services, Inc. into a wholly owned taxable subsidiary of the Company on February 1, 2001 (the "Merger") and (ii) the increase in asset management fees (\$156,000) earned from Crocker Realty Trust. These increases were partially offset by reductions in (i) fees earned under the management contract with Centoff Realty Company, Inc. ("Centoff"), a subsidiary of Morgan Guaranty Trust Company of New York and (ii) construction management fees. Management fee revenues decreased \$591,000 for 2000, as compared to 1999, due primarily to a decrease in fees earned under the Centoff management contract. On January 1, 2000, the management contract for one of the Centoff centers was transferred from KE to Koger Realty Services, Inc. During November 2000, the management contract for the remaining Centoff center was terminated when the property was sold by the third party owner. The effect of these decreases was partially offset by the asset management fees (\$296,000) earned from Crocker Realty Trust during 2000.

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Income from Koger Realty Services, Inc. Income from Koger Realty Services, Inc. decreased \$564,000 for 2001, as compared to 2000, due to the Merger. For 2000, income from Koger Realty Services, Inc. decreased \$454,000, as compared to 1999, due primarily to an increase in general and administrative expenses.

Interest Revenues. For 2001, interest revenues increased \$73,000, as

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compared to 2000, due to the higher average balance of cash to invest. Interest revenues increased \$246,000 for 2000, as compared to 1999, due to the interest earned from loans to certain current and former employees.

Expenses. Property operations expense includes such charges as utilities, real estate taxes, janitorial, maintenance, property insurance, provision for uncollectible rents and management costs. During 2001, property operations expense decreased \$260,000 or 0.4 percent, compared to 2000, primarily due to the reduction of property operations expense (\$3,365,000) caused by the sale of two office parks during 2000 and the 2001 Property Sale. Most of this decrease was offset by (i) the increases in property operations expense (\$1,870,000) from seven buildings constructed by the Company and (ii) increased accruals to provision for uncollectible accounts. During 2000, property operations expense increased by \$1,286,000 or 2.1 percent, compared to 1999, primarily due to (i) increases in property operations expense (\$5,662,000) for properties acquired and construction completed during 1999 and 2000 and (ii) increases in real estate taxes. These increases were partially offset by the decrease in property operations expense (\$5,847,000) for the properties sold during 1999 and 2000. For 2001, 2000 and 1999, property operations expense as a percentage of total rental revenues was 37.2 percent, 37.6 percent and 38.8 percent, respectively.

Depreciation expense has been calculated on the straight-line method based upon the useful lives of the Company's depreciable assets, generally 3 to 40 years. For 2001, depreciation expense increased \$605,000 or 1.9 percent, compared to 2000, due to the construction completed during 2000 and 2001. The effect of this increase was partially offset by the sale of two office parks during 2000 and the 2001 Property Sale. For 2000, depreciation expense increased \$2,976,000 or 10.2 percent, compared to the prior year, due to the properties acquired and construction completed during 1999 and 2000.

Amortization expense increased \$269,000, compared to 2000, due to deferred tenant costs incurred during 2000 and 2001. During 2000, amortization expense decreased \$157,000, compared to 1999, due to deferred tenant costs associated with properties sold during 1999 and 2000.

Interest expense decreased \$2,064,000 during 2001, compared to 2000, primarily due to (i) the decrease in the average balance of mortgages and loans payable and (ii) the decrease in the average interest rate on the Company's variable rate loans. For 2000, interest expense increased \$5,375,000, compared to 1999, primarily due to (i) the increase in the average balance of mortgages and loans payable, (ii) the reduction in interest capitalized to construction and (iii) the increase in the average interest rate on the Company's variable rate loans. During 2001, 2000, and 1999, the weighted average interest rate on the Company's variable rate loans was 5.7 percent, 7.9 percent and 6.7 percent, respectively. The Company's average outstanding amount under such loans during 2001, 2000, and 1999 was \$90,009,000, \$96,262,000, and \$95,277,000, respectively. During 2001, 2000, and 1999, the weighted average interest rate on the Company's fixed rate loans was 8.0 percent, 8.0 percent and 8.2 percent, respectively. The Company's average outstanding amount under its fixed rate loans during 2001, 2000, and 1999 was \$250,373,000, \$255,439,000, and \$225,391,000, respectively.

For 2001, general and administrative expenses decreased \$11,805,000, compared to 2000, primarily due to certain non-recurring charges incurred during 2000, which are described below. General and administrative expenses increased by \$11,584,000 during 2000, compared to 1999. This increase is primarily due to certain non-recurring charges for (i) corporate reorganization costs

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(\$8,767,000), (ii) severance payments made to certain former senior executives (\$2,562,000), (iii) changes in termination benefits under the Supplemental Executive Retirement Plan (\$704,000), (iv) payments to retiring directors (\$138,000) and (v) initial fees for listing on the New York Stock Exchange (\$161,000).

Direct costs of management fees increased \$2,480,000 during 2001, compared to 2000, primarily due to the Merger. The effect of this increase was partially offset by declines in costs due to (i) termination of the Centoff management contract and (ii) reduction in construction management services provided to third parties. For 2000, direct cost of management fees decreased \$534,000, compared to 1999, due to decreased costs associated with providing property management services under the Centoff contract.

Other expenses decreased \$28,000 during 2001, compared to 2000, primarily due to the reduction in real estate taxes on unimproved land caused by the reduction in acres held for investment and held for sale. During 2000, other expenses decreased \$926,000, compared to 1999, primarily due to (i) the reduction in costs for certain corporate strategic issues and (ii) the reduction in real estate taxes on unimproved land due to the reduction in acres held for investment and held for sale.

Management periodically reviews its investment in properties for evidence of impairments in value. Factors considered consist of, but are not limited to, the following: current and projected occupancy rates, market conditions in different geographic regions, and management's plans with respect to its properties. Where management concludes that expected cash flows will not enable the Company to recover the carrying amount of its investments, losses are recorded and asset values are reduced. No such impairments in value existed during 2001, 2000 or 1999.

Operating Results. Net income totaled \$73,223,000, \$27,153,000 and \$36,586,000 for 2001, 2000 and 1999, respectively. For 2001, net income increased \$46,070,000 or 169.7 percent from the prior year due primarily to (i) the increase in gain on sale or disposition of assets and (ii) the decreases in mortgage and loan interest and general and administrative expenses. For 2000, net income decreased \$9,433,000 or 25.8 percent from the prior year due primarily to increases in (i) general and administrative expenses due to corporate reorganization costs and other non-recurring charges, (ii) property operations expense, (iii) depreciation expense and (iv) interest expense. The effect of these increases was partially offset by increases in (i) rental revenues and (ii) gain on sale or disposition of assets.

LIQUIDITY AND CAPITAL RESOURCES

Operating Activities. During the year ended December 31, 2001, the Company generated approximately \$64 million in net cash from operating activities. The Company's primary internal sources of cash are (i) the collection of rents from buildings owned by the Company and (ii) the receipt of management fees paid to the Company in respect of properties managed on behalf of third party owners. As a REIT for Federal income tax purposes, the Company is required to pay out annually, as dividends, 90 percent of its REIT taxable income (which, due to non-cash charges, including depreciation and net operating loss carryforwards, may be substantially less than cash flow). In the past, the Company has paid out dividends in amounts at least equal to its REIT taxable income. The Company believes that its cash provided by operating activities and its current cash balance will be sufficient to cover debt service payments and to pay the dividends required to maintain REIT status through 2002.

The level of cash flow generated by rents depends primarily on the occupancy rates of the Company's buildings and changes in rental rates on new and renewed leases and under escalation provisions. As of December 31, 2001,

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approximately 97 percent of the Company's annualized gross rental revenues were derived from existing leases containing provisions for rent escalations. However, market conditions may prevent the Company from escalating rents under such provisions.

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As of December 31, 2001, leases representing approximately 21 percent of the gross annualized rent from the Company's properties, without regard to the exercise of options to renew, were due to expire during 2002. This represents 290 leases for space in buildings located in 13 of the 14 Koger Centers or locations in which the Company owns buildings. Certain of these tenants may not renew their leases or may reduce their demand for space. Leases were renewed on approximately 66 percent, 61 percent and 66 percent of the Company's rentable square feet, which were scheduled to expire during 2001, 2000 and 1999, respectively. For those leases, which renewed during 2001, the average rental rate increased from \$15.00 to \$15.80, an increase of 5.3 percent. For those leases in properties owned by the Company at December 31, 2001, which renewed during 2001, the average rental rate increased from \$14.61 to \$15.33, an increase of 4.9 percent. However, for leases in these properties which renewed during the fourth quarter of 2001, the average rental rate increased 2.9 percent. Current market conditions in certain markets may require that rental rates at which leases are renewed or at which vacated space is leased be lower than rental rates under existing leases. Based upon the amount of leases which will expire during 2002 and the competition for tenants in the markets in which the Company operates, the Company has offered, and expects to continue to offer, incentives to certain new and renewal tenants. These incentives may include the payment of tenant improvement costs and, in certain markets, reduced rents during initial lease periods.

The Company has benefited from existing economic conditions and stable vacancy levels for office buildings in many of the metropolitan areas in which the Company owns buildings. The Company believes that the southeastern region of the United States provides significant economic growth potential due to its diverse regional economies, expanding metropolitan areas, skilled work force and moderate labor costs. However, the Company cannot predict whether such economic growth will continue and the Company is currently experiencing slower growth and increasing vacancy levels in the markets in which it owns buildings. Cash flow from operations could be reduced if economic growth were not to continue in the Company's markets and if this resulted in lower occupancy rates for the Company's buildings. For the properties owned on December 31, 2001, occupancy was 90 percent at December 31, 2001 compared with 91.4 percent at December 31, 2000.

Governmental tenants (including the State of Florida and the United States of America), which accounted for 27.3 percent of the Company's leased space as of December 31, 2001, may be subject to budget reductions in times of recession and governmental austerity measures. Consequently, there can be no assurance that governmental appropriations for rents may not be reduced. Additionally, certain of the private-sector tenants, which have contributed to the Company's rent stream, may reduce their current demands, or curtail their future need, for additional office space.

On December 12, 2001, the Company began providing property management services to AP-Knight for 75 suburban office buildings and one retail center. AP-Knight acquired these properties from the Company. The Company agreed to continue to manage these properties for what it considers to be standard property management fees. This agreement is terminable by either party upon 30 days written notice. From February 1, 2001 through August 31, 2001, the Company

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provided property management services for 55 commercial office properties owned by Koala. During this period, the Company earned fees of \$3,499,000 for the management of these properties. The Company had a contract for the management of eight commercial office properties owned by Centoff. This agreement was terminated during November 2000 when the properties were sold by Centoff. The Company earned fees of \$998,000 and \$846,000 for the management of these properties during 2000 and 1999, respectively. At the end of 1999, Centoff terminated the management agreement with KE related to eight commercial office buildings. The Company earned fees of \$780,000 for the management and leasing of these properties during 1999. Another agreement to manage one commercial office building was terminated by the Company during February 1999. During 1999, the Company earned fees of \$82,000 for the management of this building.

During 2000, the Company reached an agreement with Crocker Realty Trust ("CRT") to provide asset management services for the 6.1 million square foot portfolio of CRT of which Mr. Crocker is the Chairman of the Board and Chief Executive Officer owning 2.8 percent of the outstanding CRT shares, Mr. Onisko is the Treasurer and Chief Financial Officer owning 0.2 percent of the outstanding shares and Apollo is a principal shareholder owning 49 percent of the outstanding CRT shares. The Company is paid a fee for these services based upon the value of CRT's assets. The agreement is terminable by either party upon 90 days written notice. The terms of this agreement were approved by a committee of the Company's Board of Directors whose members were not affiliated with CRT, and who determined that such terms were similar to those that could be obtained from an unaffiliated third party. The Company earned fees of \$296,000 under this agreement during the period from June 15, 2000 through December 31, 2000. During 2001, the Company earned fees of \$452,000 under this agreement. Currently, the Company provides asset management services for 4.6 million square feet owned by CRT.

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Investing Activities. At December 31, 2001, substantially all of the Company's invested assets were in real properties. Improvements to the Company's existing properties have been financed through internal operations. During 2001, the Company's expenditures for improvements to existing properties decreased by approximately \$969,000 from the prior year, primarily due to decreases in expenditures for tenant improvements. This decrease in expenditures for tenant improvements was primarily due to (i) the sale of two office parks during 2000 and (ii) the lower leasing activity of second generation space during 2001 compared to 2000.

During 2001, the Company completed the construction of two buildings, which contain 180,900 gross square feet. During 2000, the Company completed the construction of six buildings, which contain 579,200 gross square feet. During 1999, the Company completed the construction of six buildings, which contain 630,400 gross square feet.

On November 1, 1999, the Company acquired four buildings, containing 508,600 gross square feet, located in Charlotte, North Carolina and Orlando, Florida for a purchase price of \$64.1 million.

On December 12, 2001, the Company sold 75 suburban office buildings, one retail center and 3.4 acres of unimproved land for approximately \$199,587,000, net of selling costs, and 5,733,772 shares of the Company's common stock (which were valued at approximately \$96,327,000). These properties contained more than 3.9 million rentable square feet and were located throughout Austin and San Antonio, Texas; Charlotte and Greensboro, North Carolina; Greenville, South Carolina; and Birmingham, Alabama. These properties were sold to AP-Knight, an affiliate of Apollo. A director of the Company is the partner responsible for

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investments at Apollo. The transaction was negotiated by a Special Committee of the Board of Directors composed of directors who had no affiliation with Apollo. In order to insure that the terms of the transaction were equal to, or better than, a similar transaction with an unrelated third party, the Company initiated a marketing period through its financial advisor during which unrelated bidders were asked to submit competing offers to purchase these properties. Prior to the closing of the sale, the Company did not receive any attractive alternative offers for these properties. In connection with this transaction, Morgan Stanley & Co. Incorporated acted as financial advisor and provided an opinion to the Special Committee of the Board of Directors which opinion stated that the consideration received from the transaction was fair from a financial point of view to the Company.

On June 1, 2000, the Company sold the Tulsa Center (containing 476,400 multi-tenant usable square feet and 10 acres of undeveloped land) for approximately \$28,841,000, net of selling costs. The Company sold approximately 5.6 acres of unimproved land located in Richmond, Virginia, for approximately \$800,000, net of selling costs, on July 10, 2000. On August 11, 2000, the Company sold the El Paso Center (containing 315,600 multi-tenant usable square feet) for approximately \$20,075,000, net of selling costs. The sale of these properties when combined with certain property adjustments resulted in a gain of \$6,015,000. On August 31, 1999, the Company sold the Jacksonville Central Center (containing 666,000 multi-tenant usable square feet and 1.4 acres of undeveloped land) and the Charlotte East Center (containing 468,900 multi-tenant usable square feet and 3.9 acres of undeveloped land) for approximately \$68,761,000, net of selling costs.

Financing Activities. The Company's primary external sources of cash are bank borrowings, mortgage financings, and public and private offerings of equity securities. The proceeds of these financings are used by the Company to acquire buildings and land or to refinance debt. The Company has a \$125 million secured revolving credit facility provided by Fleet National Bank, Wells Fargo Bank, N.A. and Compass Bank.

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Prior to 1999, the Company's Board of Directors (the "Board") approved the repurchase of up to one million shares of the Company's common stock (the "Shares"). The Company repurchased 54,000 Shares for approximately \$852,000 during 1999. During 2000, the Board approved the repurchase of up to 2.65 million Shares and the Company repurchased 1,209,980 Shares for approximately \$20.4 million. The Company did not repurchase any Shares during 2001.

During 1999, the Company increased its non-recourse loan with Northwestern Mutual Life Insurance Company ("Northwestern") by \$45 million to a total of \$235 million, which is secured by nine office parks and one freestanding building. This loan is divided into (i) a tranche in the amount of \$100.5 million with a 10 year maturity and an average interest rate of 8.19 percent, (ii) a tranche in the amount of \$89.5 million with a maturity of 12 years and an interest rate of 8.33 percent, (iii) a tranche in the amount of \$14.7 million which matures January 2, 2007 and an interest rate of 7.1 percent and (iv) a tranche in the amount of \$30.3 million which matures on January 2, 2009 and an interest rate of 7.1 percent. Amortization with respect to this indebtedness is based on equal monthly installments over a 25 year amortization period. This indebtedness requires the Company to maintain certain financial ratios.

During December 2001, the Company repaid the \$90 million outstanding balance under the secured revolving credit facility provided by First Union National Bank of Florida, AmSouth Bank, N.A., Citizens Bank of Rhode Island,

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Compass Bank and Guaranty Federal Bank. This credit facility matured during December 2001. On December 28, 2001, the Company closed on a new \$125 million secured revolving credit facility provided by Fleet National Bank, Wells Fargo Bank, N.A. and Compass Bank. This facility provides for monthly interest payments, requires the Company to maintain certain financial ratios and matures in December 2004.

Loan maturities and normal amortization of mortgages and loans payable during the year 2002 are expected to total approximately \$12.7 million, which includes a \$7.9 million balloon payment due under a term loan which matures in December 2002. In order to generate funds sufficient to make principal payments in respect of indebtedness of the Company over the long term, as well as necessary capital and tenant acquisition expenditures, the Company will be required to successfully refinance its indebtedness or procure additional equity capital. However, there can be no assurance that any such refinancing or equity financing will be achieved or will generate adequate funds on a timely basis for these purposes. If additional funds are raised by issuing equity securities, further dilution to existing shareholders may result. Unfavorable conditions in the financial markets, the degree of leverage of the Company and various other factors may limit the ability of the Company to successfully undertake any such financings, and no assurance can be given as to the availability of alternative sources of funds. The Company has filed shelf registration statements with respect to the issuance of up to \$300 million of its common and/or preferred stock. The Company has issued \$91.6 million of its common stock under such registration statements.

In addition, in the event the Company is unable to generate sufficient funds both to meet principal payments in respect of its indebtedness and to satisfy distribution requirements of 90 percent of annual REIT taxable income to its shareholders, the Company may be unable to qualify as a REIT. In such an event, the Company (i) will incur federal income taxes and perhaps penalties, (ii) if the Company is then paying dividends, may be required to decrease any dividend payments to its shareholders, and (iii) the market price of the Company's common stock may decrease. The Company would also be prohibited from requalifying as a REIT for five years.

CAUTIONARY STATEMENT RELEVANT TO FORWARD-LOOKING INFORMATION FOR PURPOSE OF "SAFE HARBOR" PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

The Private Securities Litigation Reform Act of 1995 (the "Act") provides a "safe harbor" for forward-looking statements to encourage companies to provide prospective information about their businesses without fear of litigation so long as those statements are identified as forward-looking and are accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those projected in such statements. The Company desires to take advantage of the "safe harbor" provisions of the Act.

This Annual Report on Form 10-K contains forward-looking statements, together with related data and projections, about the Company's projected financial results and its future plans and strategies. However, actual results and needs of the Company may vary materially from forward-looking statements and projections made from time to time by the Company on the basis of management's then-current expectations. The business in which the Company is engaged involves changing and competitive markets and a high degree of risk, and there can be no assurance those forward-looking statements and projections will prove accurate.

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Accordingly, the Company hereby identifies the following important factors, which could cause the Company's actual performance and financial results to differ materially from any results, which might be projected, forecast, estimated or budgeted by the Company.

Real Estate Financing Risks

Existing Debt. The Company is subject to risks normally associated with debt financing, including (a) the risk that the Company's cash flow will be insufficient to meet required payments of principal and interest, (b) the risk that the existing debt in respect of the Company's properties (which in substantially all cases will not have been fully amortized at maturity) will not be able to be refinanced and (c) the risk that the terms of any refinancing of any existing debt will not be as favorable as the terms of such existing debt. The Company currently has outstanding debt of approximately \$248.7 million, all of which is secured by certain of the Company's properties. Approximately \$151.4 million of such debt will mature before 2008, with the majority of the remaining balance maturing in 2009. The \$125 million secured revolving credit facility (none of which was outstanding at year end) matures in December 2004. If principal payments due at maturity cannot be refinanced, extended or paid with proceeds of other capital transactions, such as new equity capital, the Company expects that its cash flow will not be sufficient to repay all such maturing debt. Furthermore, if prevailing interest rates or other factors at the time of refinancing (such as the reluctance of lenders to make commercial real estate loans) result in higher interest rates upon refinancing than the interest rates on the existing debt, the interest expense relating to such refinanced debt would increase, which would adversely affect the Company's cash flow and the amount of distributions the Company would be able to make to its shareholders. If the Company has mortgaged a property to secure payment of debt and the Company is unable to meet the mortgage payments, then the mortgagee may foreclose upon, or otherwise take control of, such property, with a consequent loss of income and asset value to the Company.

Risk of Rising Interest Rates and Variable Rate Debt. The Company currently has a \$125 million secured revolving credit facility and a term loan with variable interest rates. The Company may incur additional variable rate debt in the future. Increases in interest rates on such debt could increase the Company's interest expense, which would adversely affect the Company's cash flow and its ability to pay distributions to its shareholders.

Existing Leverage; No Limitation on Debt. As of December 31, 2001, the debt to total market capitalization ratio of the Company was approximately 41 percent. The Company's policy regarding this ratio (i.e., total consolidated debt as a percentage of the sum of the market value of issued and outstanding capital stock plus total consolidated debt) is not subject to any limitation in the organizational documents of the Company. Accordingly, the Board of Directors could establish policies which would increase the Company's debt to total market capitalization ratio. If this action were taken, the Company could become more highly leveraged, resulting in an increase in debt service that (a) could adversely affect the Company's cash flow and, consequently, the amount of cash available for distribution to shareholders and (b) could increase the risk of default on the Company's debt.

For purposes of establishing and evaluating its debt policy, the Company measures its leverage by reference to the total market capitalization of the Company rather than by reference to the book value of its assets. The Company has used total market capitalization because it believes that the book value of its assets (which to a large extent is comprised of the depreciated value of real property, the Company's primary tangible asset) does not accurately reflect its ability to borrow and to meet debt service requirements. The market capitalization of the Company, however, is more variable than book value, and does not necessarily reflect the fair market value of the underlying assets of

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the Company at all times. The Company also considers factors other than its market capitalization in making decisions regarding the incurrence of indebtedness, such as the purchase price of properties to be acquired with debt financing, the estimated market value of its properties upon refinancing and the ability of particular properties, and the Company as a whole, to generate cash flow to cover expected debt service.

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Geographic Concentration

The Company's revenues and the value of its properties may be affected by a number of factors, including the regional and local economic climates of the metropolitan areas in which the Company's buildings are located (which may be adversely impacted by business layoffs or downsizing, industry slowdowns, changing demographics and other factors) and regional and local real estate conditions in such areas (such as oversupply of, or reduced demand for, office and other competing commercial properties). All of the Company's properties are located in the southeastern United States. There is also the problem of over building in certain sub-markets located in markets which the Company currently serves. While the Company has avoided acquiring or developing property in these sub-markets such over built condition may move over into the sub-markets where the Company has property. The Company's performance and its ability to make distributions to its shareholders are, therefore, dependent on economic conditions in these market areas. The Company's historical growth has occurred during periods when the economy in the southeastern United States has out-performed the national economy. There can be no assurance as to the continued growth of the economy in the southeastern United States or the future growth rate of the Company.

Renewal of Leases and Reletting of Space

The Company is subject to the risks that upon expiration of leases for space located in its buildings (a) such leases may not be renewed, (b) such space may not be relet or (c) the terms of renewal or reletting (taking into account the cost of required renovations) may be less favorable than current lease terms. Leases on a total of 20.4 percent and 22.3 percent of the total rentable square feet leased in the Company's buildings will expire in 2002 and 2003, respectively. If the Company is unable to promptly relet, or renew the leases for, all or a substantial portion of the space located in its buildings, or if the rental rates upon such renewal or reletting are significantly lower than expected rental rates, or if the Company's reserves for these purposes prove inadequate, then the Company's cash flow and its ability to make expected distributions to its shareholders may be adversely affected.

Leases with State of Florida

At December 31, 2001, the Company had 48 leases with various departments and agencies of the State of Florida which totaled approximately 766,000 rentable square feet. The majority of these leases are for space in Office Buildings located in Tallahassee, Florida. These leases have provisions for early termination for various reasons, including lack of budget appropriations. Therefore during times of recession and government austerity measures, the State of Florida may be subject to budget reductions and may decide to terminate certain of its leases prior to the contractual lease expiration date. In addition, these leases provide the State of Florida with the right to terminate, without penalty, prior to the contractual lease expiration date in the event a State owned building becomes available for occupancy upon giving six months advance written notice to the Company.

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Real Estate Investment Risks

General Risks. Real property investments are subject to varying degrees of risk. The yields available from equity investments in real estate depend in large part on the amount of income generated and expenses incurred. If the Company's properties do not generate revenues sufficient to meet operating expenses, including current levels of debt service, tenant improvements, leasing commissions and other capital expenditures, the Company may have to borrow additional amounts to cover fixed costs and the Company's cash flow and its ability to make distributions to its shareholders will be adversely affected. The Company must obtain external financing to meet future debt maturities.

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The Company's net revenues and the value of its properties may be adversely affected by a number of factors, including the national, regional and local economic climates; regional and local real estate conditions; the perceptions of prospective tenants as to the attractiveness of the property; the ability of the Company to provide adequate management, maintenance and insurance; and increased operating costs (including real estate taxes and utilities). In addition, real estate values and income from properties are also affected by such factors as applicable laws, including tax laws, interest rate levels and the availability of financing.

Illiquidity of Real Estate. Equity real estate investments are relatively illiquid. Such illiquidity will tend to limit the ability of the Company to vary its portfolio promptly in response to changes in economic or other conditions.

Competition. Numerous office buildings compete with the Company's buildings in attracting tenants to lease space. Some of these competing buildings are newer, better located or better capitalized than some of the Company's buildings. Moreover, the Company believes that major national or regional commercial property developers will continue to seek development opportunities in the southeastern United States. These developers may have greater financial resources than the Company. The number of competitive commercial properties in a particular area could have a material adverse affect on the Company's ability to lease space in its buildings or at newly developed or acquired properties and the rents charged.

Changes in Laws. Because increases in income, service or transfer taxes are generally not passed through to tenants under leases, such increases may adversely affect the Company's cash flow and its ability to make distributions to its shareholders. The Company's properties are also subject to various federal, state and local regulatory requirements, such as requirements of the Americans with Disabilities Act (the "ADA") and state and local fire and life safety requirements. Failure to comply with these requirements could result in the imposition of fines by governmental authorities or awards of damages to private litigants. The Company believes that its properties are currently in compliance with all such regulatory requirements. However, there can be no assurance that these requirements will not be changed or that new requirements will not be imposed which would require significant unanticipated expenditures by the Company and could have an adverse affect on the Company's cash flow and expected distributions.

Uninsured Loss. The Company presently carries comprehensive liability, fire, and flood (where appropriate), extended coverage and rental loss insurance with respect to its properties, with policy specifications and insured limits

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customary for similar properties. There are, however, certain types of losses (such as from wars) that may be either uninsurable or not economically insurable. Should an uninsured loss or a loss exceeding policy limits occur, the Company could lose both its capital invested in, and anticipated profits from, one or more of its properties.

Bankruptcy and Financial Condition of Tenants. At any time, a tenant of the Company's buildings may seek the protection of the bankruptcy laws, which could result in the rejection and termination of such tenant's lease and thereby cause a reduction in the cash flow available for distribution by the Company. No assurance can be given that tenants will not file for bankruptcy protection in the future or, if any tenants file, that they will affirm their leases and continue to make rental payments in a timely manner. In addition, a tenant from time to time may experience a downturn in its business which may weaken its financial condition and result in its failure to make rental payments when due. If a tenant's lease is not affirmed following bankruptcy or if a tenant's financial condition weakens, the Company's income may be adversely affected.

Americans with Disabilities Act Compliance. Under the ADA, all public accommodations and commercial facilities are required to meet certain federal requirements relating to access and use by disabled persons. These requirements became effective in 1992. Compliance with the requirements of the ADA could require removal of access barriers and non-compliance could result in imposition of fines by the U.S. Government or an award of damages to private litigants. Although the Company believes that its properties are substantially in compliance with these requirements, the Company may incur additional costs to comply with the ADA. Although the Company believes that such costs will not have a material adverse affect on the Company, if required changes involve a greater expenditure than the Company currently anticipates, the Company's ability to make distributions to its shareholders could be adversely affected.

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Risks Involved in Property Ownership Through Partnership and Joint Ventures. Although the Company owns fee simple interests in all but 13 of its properties, in the future the Company could, if then permitted by the covenants in its loan agreements and its financial position, participate with other entities in property ownership through partnerships or joint ventures. KE is currently the general partner of Koger-Vanguard Partners, L.P., which owns 13 office buildings in Charlotte, North Carolina. Partnership or joint venture investments may, under certain circumstances, involve risks not otherwise present in property ownership, including the possibility that (a) the Company's partners or co-ventures might become bankrupt, (b) such partners or co-ventures might at any time have economic or other business interests or goals which are inconsistent with the business interests or goals of the Company, and (c) such partners or co-ventures may be in a position to take action contrary to the instructions or the requests of the Company or contrary to the Company's policies or objectives, including the Company's policy to maintain its qualification as a REIT. The Company will, however, seek to maintain sufficient control of such participants or joint ventures to permit the Company's business objectives to be achieved. There is no limitation under the Company's organizational documents as to the amount of available funds that may be invested in partnerships or joint ventures.

Impact of Inflation. The Company may experience increases in its expenses, including debt service, as a result of inflation. The Company's exposure to inflationary cost increases in property level expenses is reduced by escalation clauses, which are included in most of its leases. However, market conditions may prevent the Company from escalating rents. Inflationary pressure may

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increase operating expenses, including labor and energy costs (and, indirectly, real estate taxes) above expected levels at a time when it may not be possible for the Company to increase lease rates to offset such higher operating expenses. In addition, inflation can have secondary effects upon occupancy rates by decreasing the demand for office space in many of the markets in which the Company operates.

Although, inflation has historically often caused increases in the value of income-producing real estate through higher rentals, the Company can provide no assurance that inflation will increase the value of its properties in the future and, in fact, the rate of inflation over recent years has been considerably below that which has been experienced previously.

Risk of Development, Construction and Acquisition Activities

Within the constraints of its policy concerning leverage, the Company has and will continue to develop and construct office buildings, particularly on its undeveloped land. Risks associated with the Company's development and construction activities, including activities relating to its undeveloped land, may include: abandonment of development opportunities; construction costs of a property exceeding original estimates and possibly making the property uneconomical; insufficient occupancy rates and rents at a newly completed property to make the property profitable; unavailability of financing on favorable terms for development of a property; and the failure to complete construction and lease-up on schedule, resulting in increased debt service expense and construction costs. In addition, new development activities, regardless of whether or not they are ultimately successful, typically require a substantial portion of management's time and attention. Development activities are subject to risks relating to the inability to obtain, or delays in obtaining, all necessary zoning, land-use, building, occupancy and other required governmental permits and authorizations.

The Company will continue to acquire office buildings. Acquisitions of office buildings entail risks that investments will fail to perform in accordance with expectations. Estimates of the cost of improvements to bring an acquired building up to standards established for the market position intended for such building may prove inaccurate. In addition, there are general investment risks associated with any new real estate investment.

The Company anticipates that any future developments and acquisitions would be financed through a combination of internally generated cash, equity investments and secured or unsecured financing. If new developments are financed through construction loans, there is a risk that, upon completion of construction, permanent financing for newly developed properties may not be available or may be available only on disadvantageous terms.

Changes in Policies Without Shareholder Approval

The investment, financing, borrowing and distribution policies of the Company, as well as its policies with respect to all other activities, including growth, debt, capitalization and operations, are determined by the Board of Directors. Although the Board of Directors has no present intention to do so, these policies may be amended or revised at any time and from time to time at the discretion of the Board of Directors without a vote of the shareholders of the Company. A change in these policies could adversely affect the financial condition or results of operations of the Company or the market price of the common stock.

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Limitations of REIT Status on Business of Subsidiaries

Certain requirements for REIT qualification may in the future limit the Company's ability to increase fee development, management and leasing operations conducted, and related services offered, by the Company's subsidiaries without jeopardizing the Company's qualification as a REIT.

Adverse Consequences of Failure to Qualify as a REIT

The Company believes it has operated so as to qualify as a REIT under the Internal Revenue Code since its inception in 1988. Although management of the Company intends that the Company continue to operate so as to qualify as a REIT, no assurance can be given that the Company will remain qualified as a REIT. Qualification as a REIT involves the application and satisfaction of highly technical and complex Code requirements for which there are only limited judicial and administrative interpretations. Uncertainty in the application of such requirements, as well as circumstances not entirely within the Company's control, may affect the Company's ability to qualify as a REIT. In addition, no assurance can be given that legislation, new regulations, administrative interpretations or court decisions will not significantly change the tax laws with respect to qualification as a REIT or the federal income tax consequences of such qualification. The Company, however, is not aware of any pending tax legislation that would adversely affect the Company's ability to operate as a REIT.

Possible Environmental Liabilities

Under various federal, state and local environmental laws, ordinances and regulations, a current or previous owner or operator of real estate may be required to investigate and clean up hazardous or toxic substances or petroleum product releases at such property and may be held liable to a governmental entity or to third parties for property damage and for investigation and clean-up costs incurred by such parties in connection with the contamination. Such laws typically impose clean-up responsibility and liability without regard to whether the owner knew, or caused the presence, of the contaminants, and the liability under such laws has been interpreted to be joint and several unless the harm is divisible and there is a reasonable basis for allocation of responsibility. The costs of investigation, remediation or removal of such substances may be substantial, and the presence of such substances, or the failure to properly remediate the contamination on such property, may adversely affect the owner's ability to sell or rent such property or to borrow using such property as collateral. Any person who arranges for the disposal or treatment of hazardous or toxic substances at a disposal or treatment facility also may be liable for the costs of removal or remediation of a release of hazardous or toxic substances at such disposal or treatment facility, whether or not such facility is owned or operated by such person. In addition, some environmental laws create a lien on the contaminated site in favor of the government for damages and costs that it incurs in connection with the contamination. Finally, the owner of a site may be subject to common law claims by third parties based on damages and costs resulting from environmental contamination emanating from a site.

Certain federal, state and local laws, regulations and ordinances govern the removal, encapsulation or disturbance of asbestos-containing materials ("ACM") when such materials are in poor condition or in the event of construction, remodeling, renovation or demolition of a building. Such laws may impose liability for release of ACM and may provide for third parties to seek recovery from owners or operators of real properties for personal injury associated with ACM. In connection with its ownership and operation of its properties, the Company may be potentially liable for such costs. All ACM in the Company's buildings has been found to be in good condition and non-friable, and

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should not present a risk as long as it continues to be properly managed.

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The Company's environmental assessments of its properties have not revealed any environmental liability that the Company believes would have a material adverse affect on its business, assets or results of operations taken as a whole, nor is the Company aware of any such material environmental liability. Nevertheless, it is possible that the Company's assessments do not reveal all environmental liabilities or that there are material environmental liabilities of which the Company is unaware. Moreover, there can be no assurance that future laws, ordinances or regulations will not impose any material environmental liability or the current environmental condition of the Company's properties will not be affected by tenants, by the condition of land or operations in the vicinity of such properties (such as the presence of underground storage tanks), or by third parties unrelated to the Company.

Effect of Market Interest Rates on Price of Common Stock

One of the factors that will influence the market price of the Company's common stock in public markets will be the annual dividend yield on the share price reflected by dividend distributions by the Company. An increase in market interest rates could reduce cash available for distribution by the Company to its shareholders and, accordingly, adversely affect the market price of the common stock.

Additional Information

For additional disclosure of risk factors to which the Company is subject, see the other sections of "Management's Discussion and Analysis of Financial Condition and Results of Operations."

Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Risk

The Company currently has a \$125 million secured revolving credit facility and a term loan with variable interest rates. The Company may incur additional variable rate debt in the future to meet its financing needs. Increases in interest rates on such debt could increase the Company's interest expense, which would adversely affect the Company's cash flow and its ability to pay distributions to its shareholders. The Company has not entered into any interest rate hedge contracts in order to mitigate the interest rate risk with respect to the secured revolving credit facility. As of December 31, 2001, the Company had \$1.5 million outstanding under loans with variable interest rates. If the weighted average interest rate on this variable rate debt were 100 basis points higher or lower, annual interest expense would be increased or decreased by approximately \$15,000.

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Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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INDEX TO CONSOLIDATED FINANCIAL STATEMENTS
AND FINANCIAL STATEMENT SCHEDULES

Independent Auditors' Report.....

Consolidated Financial Statements:

 Consolidated Balance Sheets as of December 31, 2001
 and 2000.....

 Consolidated Statements of Operations for Each
 of the Three Years in the Period Ended
 December 31, 2001.....

 Consolidated Statements of Changes in Shareholders'
 Equity for Each of the Three Years in the
 Period Ended December 31, 2001.....

 Consolidated Statements of Cash Flows for Each
 of the Three Years in the Period Ended
 December 31, 2001.....

 Notes to Consolidated Financial Statements for
 Each of the Three Years in the Period Ended
 December 31, 2001.....

Financial Statement Schedules:

 Schedule II - Valuation and Qualifying Accounts
 for the Three Years Ended December 31, 2001.....

 Schedule III - Real Estate and Accumulated
 Depreciation as of December 31, 2001.....

INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Shareholders of
Koger Equity, Inc.
Boca Raton, Florida

We have audited the accompanying consolidated balance sheets of Koger Equity, Inc. and subsidiaries (the "Company") as of December 31, 2001 and 2000, and the related consolidated statements of operations, changes in shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2001. Our audits also included the financial statement schedules listed in the Index at Item 8. These financial statements and financial statement schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedules based on our audits.

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We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Koger Equity, Inc. and subsidiaries as of December 31, 2001 and 2000, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2001 in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedules, when considered in relation to the basic consolidated financial statements taken as a whole, present fairly in all material respects the information set forth therein.

As described in Note 2 to the consolidated financial statements, the Company has sold operating properties with over 3.9 million rentable square feet in exchange for cash and shares of the Company's common stock. The purchaser, AP-Knight LP, an affiliate of Apollo Real Estate Advisors, LP, was a related party at the date of the transaction.

DELOITTE & TOUCHE LLP
 Certified Public Accountants

West Palm Beach, Florida
 February 22, 2002

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KOGER EQUITY, INC. AND SUBSIDIARIES
 CONSOLIDATED BALANCE SHEETS
 AS OF DECEMBER 31, 2001 AND 2000
 (In Thousands Except Share Data)

	2001
ASSETS	
Real estate investments:	
Operating properties:	
Land	\$ 91,919
Buildings	568,285
Furniture and equipment	3,082
Accumulated depreciation	(123,999)
Operating properties - net	539,287
Properties under construction:	
Land	-

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Buildings	-
Undeveloped land held for investment	13,779
Undeveloped land held for sale, net of allowance	76
Cash and cash equivalents	113,370
Accounts receivable, net of allowance for uncollectible accounts of \$1,114 and \$584	11,574
Investment in Koger Realty Services, Inc.	-
Cost in excess of fair value of net assets acquired, net of accumulated amortization of \$683 and \$1,195	595
Other assets	11,904

TOTAL ASSETS	\$690,585
	=====
LIABILITIES AND SHAREHOLDERS' EQUITY	
Liabilities:	
Mortgages and loans payable	\$248,683
Accounts payable	4,962
Accrued real estate taxes payable	1,007
Accrued liabilities - other	9,206
Dividends payable	44,159
Advance rents and security deposits	5,103

Total Liabilities	313,120

Minority interest	22,923

Commitments and contingencies (Notes 2 and 10)	
Shareholders' equity:	
Preferred stock, \$.01 par value; 50,000,000 shares authorized; issued: none	-
Common stock, \$.01 par value; 100,000,000 shares authorized; issued: 29,663,362 and 29,559,381 shares; outstanding: 21,128,905 and 26,829,239 shares	297
Capital in excess of par value	469,779
Notes receivable from stock sales	(5,066)
Retained earnings	21,180
Treasury stock, at cost; 8,534,457 and 2,730,142 shares	(131,648)

Total Shareholders' Equity	354,542

TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$690,585
	=====

See Notes to Consolidated Financial Statements.

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	2001	

Revenues		
Rental	\$164,679	\$1
Other rental services	944	
Management fees	4,080	
Income from Koger Realty Services, Inc.	81	
Interest	776	
	-----	-----
Total revenues	170,560	1
	-----	-----
Expenses		
Property operations	61,608	
Depreciation and amortization	36,007	
Mortgage and loan interest	25,204	
General and administrative	8,412	
Direct cost of management fees	3,378	
Other	189	
	-----	-----
Total expenses	134,798	1
	-----	-----
Income Before Gain on Sale or Disposition of Assets, Income Taxes and Minority Interest	35,762	
Gain on sale or disposition of assets	39,189	
	-----	-----
Income Before Income Taxes and Minority Interest	74,951	
Income tax provision (benefit)	684	
	-----	-----
Income Before Minority Interest	74,267	
Minority interest	1,044	
	-----	-----
Net Income	\$ 73,223	\$
	=====	=====
Earnings Per Share:		
Basic	\$ 2.76	\$
	=====	=====
Diluted	\$ 2.75	\$
	=====	=====
Weighted Average Shares:		
Basic	26,517	
	=====	=====
Diluted	26,610	
	=====	=====

See Notes to Consolidated Financial Statements.

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KOGER EQUITY, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
FOR EACH OF THE THREE YEARS IN THE PERIOD
ENDED DECEMBER 31, 2001
(In Thousands)

	Common Shares Issued	Stock Par Value	Capital in Excess of Par Value	Notes Receivable from Stock Sales	Retain Earnings
	-----	-----	-----	-----	-----
BALANCE, DECEMBER 31, 1998	28,560	\$286	\$454,988		\$30,020
Common stock sold			207		
Treasury stock reissued			123		
Treasury stock purchased					
Options exercised	174	2	2,120		
Restricted stock issued	22		368		
401(k) Plan contribution			139		
Dividends declared					(36,060)
Net income					36,586
	-----	--	-----	-----	-----
BALANCE, DECEMBER 31, 1999	28,756	288	457,945		30,546
Common stock sold			220	\$ (5,066)	
Treasury stock purchased					
Options exercised	803	8	10,026	(1,184)	
Restricted stock issued			(48)		
401(k) Plan contribution			134		
Dividends declared					(37,438)
Net income					27,153
	-----	--	-----	-----	-----
BALANCE, DECEMBER 31, 2000	29,559	296	468,277	(6,250)	20,261
Common stock sold			125		
Stock loan repayments				1,184	
Treasury stock acquired					
Options exercised	104	1	1,377		
Dividends declared					(72,304)
Net income					73,223
	-----	--	-----	-----	-----
BALANCE, DECEMBER 31, 2001	29,663	\$297	\$469,779	\$ (5,066)	\$21,180
	=====	=====	=====	=====	=====

See Notes to Consolidated Financial Statements.

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KOGER EQUITY, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR EACH OF THE THREE YEARS IN THE PERIOD
ENDED DECEMBER 31, 2001
(In Thousands)

	2001 -----	2000 -----
Operating Activities		
Net income	\$ 73,223	\$ 27,153
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	36,007	35,133
Income from Koger Realty Services, Inc.	(81)	(645)
Provision for uncollectible accounts	1,448	721
Minority interest	1,044	1,156
Gain on sale or disposition of assets	(39,189)	(6,015)
Changes in assets and liabilities:		
Increase (decrease) in accounts payable, accrued liabilities and other liabilities	(7,116)	(6,096)
Increase in accounts receivable and other assets	(1,343)	(2,765)
	-----	-----
Net cash provided by operating activities	63,993	48,642
	-----	-----
Investing Activities		
Proceeds from sales of assets	199,646	49,726
Cash acquired in purchase of assets from KRSI	2,535	-
Dividends received from Koger Realty Services, Inc.	-	431
Property acquisitions	-	(10)
Building and land construction expenditures	(2,012)	(16,184)
Tenant improvements to first generation space	(4,363)	(7,133)
Tenant improvements to existing properties	(6,610)	(8,362)
Building improvements	(4,899)	(4,065)
Energy management improvements	(201)	(252)
Deferred tenant costs	(2,338)	(3,812)
Additions to furniture and equipment	(177)	(402)
	-----	-----
Net cash provided by (used in) investing activities	181,581	9,937
	-----	-----
Financing Activities		
Proceeds from mortgages and loans	42,500	76,783
Proceeds from sales of common stock	259	2,159
Proceeds from exercise of stock options	1,373	8,204
Collection of notes receivable from stock sales	174	-
Principal payments on mortgages and loans	(137,104)	(85,024)
Dividends paid	(37,537)	(37,416)
Distributions paid to minority interest holders	(1,259)	(1,202)
Treasury stock purchased	-	(20,434)
Financing costs	(2,225)	(34)
	-----	-----
Net cash provided by (used in) financing activities	(133,819)	(56,964)

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Net increase (decrease) in cash and cash equivalents	111,755	1,615
Cash and cash equivalents - beginning of year	1,615	0
Cash and cash equivalents - end of year	\$113,370	\$ 1,615

See Notes to Consolidated Financial Statements.

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KOGER EQUITY, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR EACH OF THE THREE YEARS IN THE PERIOD
ENDED DECEMBER 31, 2001

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES.

Organization. Koger Equity, Inc. ("KE") was incorporated in Florida on June 21, 1988. KE has three wholly-owned subsidiaries, which are Southeast Properties Holding Corporation ("Southeast"), a Florida corporation; Koger Real Estate Services, Inc. ("KRES"), a Florida corporation; and Koger Realty Services, Inc. ("KRSI"), a Florida corporation. Koger-Vanguard Partners, L.P. ("KVP") is a Delaware limited partnership, for which KE is the general partner.

Principles of Consolidation. The consolidated financial statements include the accounts of KE, its wholly-owned subsidiaries and KVP (the "Company"). All material intercompany transactions and accounts have been eliminated in consolidation.

Investment in Koger Realty Services, Inc. During January 2001, KE organized KRSI Merger, Inc., a Florida corporation, as a wholly owned taxable subsidiary. Effective February 1, 2001, Koger Realty Services, Inc. ("Koger Realty"), a Delaware corporation, was merged into this new subsidiary (the "Merger"). Pursuant to the Merger, the common stock of Koger Realty was repurchased at the formula price set forth in its Articles of Incorporation. All of the outstanding common stock of Koger Realty was owned by officers and employees of Koger Realty, some of whom were also officers of KE. Subsequent to the Merger, the name of the new Florida subsidiary was changed to Koger Realty Services, Inc. This merger was accounted for using the purchase method of accounting resulting in a reduction in the cost basis of assets of approximately \$143,000. Prior to the Merger, the Company accounted for its investment in the preferred stock of Koger Realty using the equity method.

Real Estate Investments. Operating properties, properties under construction, furniture and equipment, and undeveloped land held for investment are stated at cost less accumulated depreciation. Undeveloped land held for sale is carried at the lower of cost or fair value less selling costs.

Periodically, management reviews its portfolio of operating properties, undeveloped land held for investment and related goodwill and in those instances where properties have suffered an impairment in value, the properties and related goodwill will be reduced to their fair value. This review includes a quarterly analysis of occupancy levels and rental rates for the Company's properties in order to identify properties, which may have suffered an

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impairment in value. Management prepares estimates of future undiscounted cash flows for these properties to determine whether the Company will be able to recover its investment. In making such estimates, management considers the conditions in the commercial real estate markets in which the properties are located, current and expected occupancy rates, current and expected rental rates, and expected changes in operating costs. As of December 31, 2001, there were no such impairments in value. Maintenance and repairs are charged to operations. Acquisitions, additions, and ime adoption of ASU 2012-02 is not expected to have a material impact on our financial position or results of operations.

In August 2012, the FASB issued ASU 2012-03, “Technical Amendments and Corrections to SEC Sections: Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin (SAB) No. 114, Technical Amendments Pursuant to SEC Release No. 33-9250, and Corrections Related to FASB Accounting Standards Update 2011-22 (SEC Update)” in Accounting Standards Update No. 2012-03. This update amends various SEC paragraphs pursuant to the issuance of SAB No. 114. The adoption of ASU 2012-03 is not expected to have a material impact on our financial position or results of operations.

Toro Ventures Inc.

**Notes to Unaudited Financial Statements
For the Three Months Ended September 30, 2011
(Expressed in U.S. Dollars)**

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

In October 2012, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2012-04, "Technical Corrections and Improvements" in Accounting Standards Update No. 2012-04. The amendments in this update cover a wide range of Topics in the Accounting Standards Codification. These amendments include technical corrections and improvements to the Accounting Standards Codification and conforming amendments related to fair value measurements. The amendments in this update will be effective for fiscal periods beginning after December 15, 2012. The adoption of ASU 2012-04 is not expected to have a material impact on our financial position or results of operations.

In February 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2013-02, Comprehensive Income (Topic 220): Reporting of Amounts Reclassified out of Accumulated Other Comprehensive Income. . The guidance in ASU 2013-02 is intended to provide guidance in the reclassification of Accumulated Other Comprehensive Income to net income. The amendments in this ASU are effective for fiscal years beginning after December 15, 2012. Early adoption is permitted if an entity's financial statements for the most recent annual or interim period have yet been issued.

3. GOING CONCERN

The Company's financial statements are prepared using the generally accepted accounting principles applicable to a going concern, which contemplates the realization of assets and liquidation of liabilities in the normal course of business. However, the Company has not commenced its planned principal operations and has generated no revenues. In order to obtain the necessary capital, the Company is in the process of raising funds from private placement subscriptions. The Company is dependent upon its ability to secure equity and/or debt financing and there are no assurances that the Company will be successful, without sufficient financing it would be unlikely for the Company to continue as a going concern.

4. INTEREST IN OIL AND GAS PROPERTIES

By a letter of intent dated March 26, 2010, the Company acquired a 15% working interest in the Quinlan #3 Oil and Gas lease in Pottowatomie County, Oklahoma in consideration for the payments totaling \$67,500. By a turnkey agreement effectively dated March 29, 2010, the Company acquired a 60% working interest in an oil and gas lease known as the Crown Oil and Gas Lease in Pottowatomie County, Oklahoma for \$250,000.

The oil and gas properties that the company has have had all costs related to the properties expensed in accordance with Generally Accepted Accounting Principles for the industry. Currently the Company does not have proven reserves confirmed with a geological study and will only be able to capitalize properties once reserves have been proven. The company performed an impairment analysis at the end of 2011 and determined that the properties were not economically viable; at that point the company impaired the properties.

Toro Ventures Inc.

**Notes to Unaudited Financial Statements
For the Three Months Ended September 30, 2011
(Expressed in U.S. Dollars)**

5. INCOME TAXES

The Company has tax losses of \$726,287 which may be applied against future taxable income. The Company has not recorded a corresponding future tax asset.

6. LOAN FROM SHAREHOLDER AND RELATED PARTY TRANSACTIONS

A shareholder has loaned the company \$85,391, without interest and fixed term of repayment. The loan is unsecured.

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

Forward-Looking Statements

This quarterly report contains forward-looking statements as that term is defined in the Private Securities Litigation Reform Act of 1995. These statements relate to future events or our future financial performance. In some cases, you can identify forward-looking statements by terminology such as "may", "should", "expects", "plans", "anticipates", "believes", "estimates", "predicts", "potential" or "continue" or the negative of these terms or other comparable terminology. These statements are only predictions and involve known and unknown risks, uncertainties and other factors, including the risks in the section entitled "Risk Factors", that may cause our or our industry's actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by these forward-looking statements. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. Except as required by applicable law, including the securities laws of the United States, we do not intend to update any of the forward-looking statements to conform these statements to actual results.

Our unaudited financial statements prepared in accordance with United States Generally Accepted Accounting Principles. The following discussion should be read in conjunction with our financial statements and the related notes that appear elsewhere in this quarterly report. The following discussion contains forward-looking statements that reflect our plans, estimates and beliefs. Our actual results could differ materially from those discussed in the forward looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed below and elsewhere in this quarterly report, particularly in the section entitled "Risk Factors" of this quarterly report.

In this quarterly report, unless otherwise specified, all dollar amounts are expressed in United States dollars. All references to "common shares" refer to the common shares in our capital stock.

As used in this quarterly report, the terms "we", "us", "our" and "Toro" mean Toro Ventures Inc., unless otherwise indicated.

General Overview

We were incorporated pursuant to the laws of the State of Nevada on April 11, 2005 under the name Toro Ventures Inc. We were initially in the fast food services industry.

The address of our principal executive office is Suite 632, 22837 Pacific Coast Highway, Malibu, CA 90265. Our telephone number is 310-887-6391.

Our common shares became listed on the OTC Bulletin Board on July 12, 2010, under the symbol "TORO". Prior to this date, there was no public market for our common shares.

We were not successful in implementing our business plan as fast food services business. As management of our company investigated opportunities and challenges in the business of being a fast food services company, management realized that the business did not present the best opportunity for our company to realize value for our shareholders. As a result, we investigated several other business opportunities to enhance shareholder value, and focused on the oil and gas industry.

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On March 26, 2010, we acquired a 15% working interest in the Quinlan #3 Oil and Gas lease in Pottowatomie County, Oklahoma in consideration for the payments totaling \$67,500.

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By a turnkey agreement dated March 29, 2010, we acquired a 60% working interest in an oil and gas lease known as the Crown Oil and Gas Lease in Pottowatomie County, Oklahoma for \$250,000.

We are an exploration stage oil and gas company engaged in the exploration for oil and gas in Oklahoma.

We intend to continue to acquire high quality oil and gas properties, primarily "proved producing and proved undeveloped reserves" in the United States. We see significant opportunities in acquiring properties with proven producing reserves and undeveloped acreage in fields that have a long history of production. We will also explore low-risk development drilling and work-over opportunities with experienced, strong operators. We will attempt to finance oil and gas operations through a combination of privately placed debt and/or equity. There can be no assurance that we will be successful in finding financing, or even if financing is found, that we will be successful in acquiring oil and/or gas assets that result in profitable operations.

We are continuing our efforts to identify and assess investment opportunities in oil and natural gas properties, utilizing the labor of our directors and stockholders until such time as funding is sourced from the capital markets. It is anticipated that we will require funding over the next twelve months to continue our operation. Attempts are ongoing to raise funds through private placements and said attempts will continue throughout 2011.

Our operating expenses will increase as we undertake our plan of operations. The increase will be attributable to the continuing geological exploration and acquisition programs and continued professional fees that will be incurred.

Purchase of Significant Equipment

We do not intend to purchase any significant equipment (excluding oil and gas activities) over the twelve months ending June 30, 2011.

Employees

Currently our only employees are our directors and officers. We do not expect any material changes in the number of employees over the next 12 month period. We do and will continue to outsource contract employment as needed. However, with project advancement and if we are successful in our initial and any subsequent drilling programs we may retain additional employees.

Results of Operations

The following summary of our results of operations should be read in conjunction with our financial statements for the three months ended September 30, 2011, which are included herein.

	Three months ended		
	September 30, 2011	September 30, 2010	Difference
OPERATING EXPENSES			
Management Fees	3,000		3,000 -
Rent	1,000	1,000	-
Total Operating Expenses	4,000		4,000 -
INCOME (LOSS)	(4,000)		(4,000) -

We are currently, using all of our resources to find requisite funding to exploit the oil and gas assets acquired. The costs for providing this services is \$4,000 per quarter..

Our accumulated losses increased to \$710,287 as of September 30, 2011. Our financial statements report a net loss of \$4,000 for YTD -2011 compared to a net loss of \$4,000 for YTD -2011.

Liquidity and Financial Condition

At September 30, 2011 and June 30, 2011, we had a working capital deficit of \$107,787.

At September 30, 2010, our total assets were \$Nil.

At September 30, 2010, our total liabilities were \$100,787, of which \$15,396 consisted of accounts payable and accrued liabilities and \$85,391 consisted of shareholder loans.

Equity Compensation

We currently do not have any stock option or equity compensation plans or arrangements.

Contractual Obligations

As a “smaller reporting company”, we are not required to provide tabular disclosure obligations.

Off-Balance Sheet Arrangements

We have no significant off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to stockholders.

Going Concern

We have suffered recurring losses from operations. The continuation of our company as a going concern is dependent upon our company attaining and maintaining profitable operations and/or raising additional capital. The financial statements do not include any adjustment relating to the recovery and classification of recorded asset amounts or the amount and classification of liabilities that might be necessary should our company discontinue operations.

The continuation of our business is dependent upon us raising additional financial support and/or attaining and maintaining profitable levels of internally generated revenue. The issuance of additional equity securities by us could result in a significant dilution in the equity interests of our current stockholders. Obtaining commercial loans, assuming those loans would be available, will increase our liabilities and future cash commitments.

Item 3. Critical Accounting Policies

Resource Properties - Company follows the successful efforts method of accounting for its oil and gas properties. Unproved oil and gas properties are periodically assessed and any impairment in value is charged to exploration expense. The costs of unproved properties, which are determined to be productive are transferred to proved resource properties and amortized on an equivalent unit-of-production basis. Exploratory expenses, including geological and geophysical expenses and delay rentals for unevaluated resource properties, are charged to expense as incurred. Exploratory drilling costs are charged as expenses until it is determined that the company has proven oil and gas reserves.

Basis of Presentation -These financial statements and related notes are presented in accordance with accounting principles generally accepted in the United States, and are expressed in U.S. dollars. The Company's fiscal year-end is June 30.

Use of Estimates - The preparation of financial statements in accordance with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of net revenue and expenses in the reporting period. We regularly evaluate our estimates and assumptions related to the useful life and recoverability of long-lived assets, stock-based compensation and deferred income tax asset valuation allowances. We base our estimates and assumptions on current facts, historical experience and various other factors that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities and the accrual of costs and expenses that are not readily apparent from other sources. The actual results experienced by us may differ materially and adversely from our estimates. To the extent there are material differences between our estimates and the actual results, our future results of operations will be affected.

Cash and Cash Equivalents - The Company considers all highly liquid instruments with original maturities of three months or less when acquired, to be cash equivalents. We had no cash equivalents at September 30, 2011 or June 30, 2007, respectively.

Asset Retirement Obligation (ARO) - The estimated costs of restoration and removal of facilities are accrued. The fair value of a liability for an asset's retirement obligation is recorded in the period in which it is incurred and the corresponding cost capitalized by increasing the carrying amount of the related long-lived asset. The liability is accreted to its then present value each period, if the liability is settled for an amount other than the recorded amount, a gain or loss is recognized. The ARO at September 30, 2011 - \$Nil and June 30, 2007 - \$Nil.

Income Taxes - Potential benefits of income tax losses are not recognized in the accounts until realization is more likely than not. The Company has adopted ASC 740, *Income Taxes*, as of its inception. Pursuant to ASC 740, the Company is required to compute tax asset benefits for net operating losses carried forward. The potential benefits of net operating losses have not been recognized in these financial statements because the Company cannot be assured it is more likely than not it will utilize the net operating losses carried forward in future years.

Comprehensive Loss- ASC 220, *Comprehensive Income*, establishes standards for the reporting and display of comprehensive loss and its components in the financial statements. As of September 30, 2011 and 2007, the Company has no items that represent comprehensive loss and, therefore, has not included a schedule of comprehensive loss in the financial statements.

Stock Based Compensation- ASC 718, *Stock-based compensation*, establishes standards for the reporting and display of stock based compensation in the financial statements. During the year ended September 30, 2011, there was no stock based compensation.

Loss per Common Share- The Company computes net loss per share in accordance with ASC 260, *Earnings Per Share*, which requires presentation of both basic and diluted earnings per share (EPS) on the face of the income statement. Basic EPS is computed by dividing net loss available to common shareholders (numerator) by the weighted average number of shares outstanding (denominator) during the period. Diluted EPS gives effect to all dilutive potential common shares outstanding during the period using the treasury stock method and convertible preferred stock using the if-converted method. In computing Diluted EPS, the average stock price for the period is used in determining the number of shares assumed to be purchased from the exercise of stock options or warrants. Diluted EPS excludes all dilutive potential shares if their effect is anti-dilutive.

Fair Value of Financial Instruments- ASC 820, “*Fair Value Measurements*” and ASC 825, Financial Instruments, requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. It establishes a fair value hierarchy based on the level of independent, objective evidence surrounding the inputs used to measure fair value. A financial instrument’s categorization within the fair value hierarchy is based upon the lowest level of input that is significant to the fair value measurement. It prioritizes the inputs into three levels that may be used to measure fair value:

Level 1

Level 1 applies to assets or liabilities for which there are quoted prices in active markets for identical assets or liabilities.

Level 2

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Level 2 applies to assets or liabilities for which there are inputs other than quoted prices that are observable for the asset or liability such as quoted prices for similar assets or liabilities in active markets; quoted prices for identical assets or liabilities in markets with insufficient volume or infrequent transactions (less active markets); or model-derived valuations in which significant inputs are observable or can be derived principally from, or corroborated by, observable market data.

Level 3

Level 3 applies to assets or liabilities for which there are unobservable inputs to the valuation methodology that are significant to the measurement of the fair value of the assets or liabilities.

The following schedule summarizes the valuation of financial instruments at fair value on a recurring basis in the balance sheets as of December 31, 2012 and 2011:

Fair Value Measurement at September 30, 2011

	Level 1	Level 2	Level 3
Liabilities			
Asset Retirement Obligations	\$ -	\$ -	\$ -
	\$ -	\$ -	\$ -

Fair Value Measurement at June 30, 2011

	Level 1	Level 2	Level 3
Liabilities			
Asset Retirement Obligations	\$ -	\$ -	\$ -
	\$ -	\$ -	\$ -

There were no transfers of financial assets or liabilities between Level 1 and Level 2 inputs for the three months ended September 30, 2011 and 2007

Recently Adopted Accounting Pronouncements

In July 2012, the FASB issued ASU 2012-02, “Intangibles – Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment” in Accounting Standards Update No. 2012-02. This update amends ASU 2011-08, Intangibles – Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment and permits an entity first to assess qualitative factors to determine whether it is more likely than not that an indefinite-lived intangible asset is impaired as a basis for determining whether it is necessary to perform the quantitative impairment

test in accordance with Subtopic 350-30, Intangibles - Goodwill and Other - General Intangibles Other than Goodwill. The amendments are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. Early adoption is permitted, including for annual and interim impairment tests performed as of a date before July 27, 2012, if a public entity's financial statements for the most recent annual or interim period have not yet been issued or, for nonpublic entities, have not yet been made available for issuance. The adoption of ASU 2012-02 is not expected to have a material impact on our financial position or results of operations.

In August 2012, the FASB issued ASU 2012-03, "Technical Amendments and Corrections to SEC Sections: Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin (SAB) No. 114, Technical Amendments Pursuant to SEC Release No. 33-9250, and Corrections Related to FASB Accounting Standards Update 2011-22 (SEC Update)" in Accounting Standards Update No. 2012-03. This update amends various SEC paragraphs pursuant to the issuance of SAB No. 114. The adoption of ASU 2012-03 is not expected to have a material impact on our financial position or results of operations.

In October 2012, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2012-04, "Technical Corrections and Improvements" in Accounting Standards Update No. 2012-04. The amendments in this update cover a wide range of Topics in the Accounting Standards Codification. These amendments include technical corrections and improvements to the Accounting Standards Codification and conforming amendments related to fair value measurements. The amendments in this update will be effective for fiscal periods beginning after December 15, 2012. The adoption of ASU 2012-04 is not expected to have a material impact on our financial position or results of operations.

In February 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2013-02, Comprehensive Income (Topic 220): Reporting of Amounts Reclassified out of Accumulated Other Comprehensive Income. . The guidance in ASU 2013-02 is intended to provide guidance in the reclassification of Accumulated Other Comprehensive Income to net income. The amendments in this ASU are effective for fiscal years beginning after December 15, 2012. Early adoption is permitted if an entity's financial statements for the most recent annual or interim period have yet been issued.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

We maintain disclosure controls and procedures, as defined in Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934 (the "Exchange Act"), that are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

We carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of September 30, 2011. Based on the evaluation of these disclosure controls and procedures, and in light of the material weaknesses found in our internal controls over financial reporting, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were not effective.

Management's Report on Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Exchange Act Rule 13a-15(f). The Company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Under the supervision and with the participation of management, including the Chief Executive Officer /Chief Financial Officer, the Company conducted an evaluation of the effectiveness of the Company's internal control over financial reporting as of September 30, 2011 using the criteria established in "*Internal Control - Integrated Framework*" issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO").

A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the Company's annual or interim financial statements will not be prevented or detected on a timely basis. In its assessment of the effectiveness of internal

control over financial reporting as of September 30, 2011, the Company determined that there were control deficiencies that constituted material weaknesses, as described below.

1) *We do not have an Audit Committee* – While not being legally obligated to have an audit committee, it is the management’s view that such a committee, including a financial expert member, is an utmost important entity level control over the Company’s financial statement. Currently the Board of Directors acts in the capacity of the Audit Committee, and does not include a member that is considered to be independent of management to provide the necessary oversight over management’s activities.

2) *We did not maintain appropriate cash controls* – As of September 30, 2011, the Company has not maintained sufficient internal controls over financial reporting for the cash process, including failure to segregate cash handling and accounting functions, and did not require dual signature on the Company’s bank accounts. Alternatively, the effects of poor cash controls were mitigated by the fact that the Company had limited transactions in their bank accounts.

3) *We did not implement appropriate information technology controls* – As of September 30, 2011, the Company retains copies of all financial data and material agreements; however there is no formal procedure or evidence of normal backup of the Company’s data or off-site storage of the data in the event of theft, misplacement, or loss due to unmitigated factors.

Accordingly, the Company concluded that these control deficiencies resulted in a reasonable possibility that a material misstatement of the annual or interim financial statements will not be prevented or detected on a timely basis by the company’s internal controls.

As a result of the material weaknesses described above, management has concluded that the Company did not maintain effective internal control over financial reporting as of September 30, 2011 based on criteria established in Internal Control—Integrated Framework issued by COSO.

Changes in Internal Control over Financial Reporting

There has been no change in our internal control over financial reporting identified in connection with our evaluation we conducted of the effectiveness of our internal control over financial reporting as of September 30, 2011, that occurred during our fourth fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

This annual report does not include an attestation report of the Company’s registered public accounting firm regarding internal control over financial reporting. Managements report was not subject to attestation by the Company’s registered public accounting firm pursuant to temporary rules of the SEC that permit the Company to provide only management’s report in this annual report.

PART II OTHER INFORMATION

Item 1. Legal Proceedings

We know of no material, existing or pending legal proceedings against our company, nor are we involved as a plaintiff in any material proceeding or pending litigation. There are no proceedings in which any of our directors, executive officers or affiliates, or any registered or beneficial stockholder, is an adverse party or has a material interest adverse to our interest.

Item 1A. Risk Factors

We are in the oil business and we expect to incur operating losses for the foreseeable future.

We have no way to evaluate the likelihood that our business will be successful. We have earned minimal revenues as of the date of this annual report. Potential investors should be aware of the difficulties normally encountered by exploration companies and the high rate of failure of such enterprises. The likelihood of success must be considered in light of the problems, expenses, difficulties, complications and delays encountered in connection with the exploration and development of the properties that we plan to undertake. These potential problems include, but are not limited to, unanticipated problems relating to exploration, and additional costs and expenses that may exceed current estimates. Prior to completion of our exploration stage, we anticipate that we will incur increased operating expenses without greatly increasing our revenues. We expect to incur significant losses into the foreseeable future. We recognize that if production is not forthcoming, we will not be able to continue business operations. There is no history upon which to base any assumption as to the likelihood that we will prove successful, and it is doubtful that we will generate significant revenues to achieve profitable operations. If we are unsuccessful in addressing these risks, our business will most likely fail.

We have yet to earn significant revenue to achieve profitability and our ability to sustain our operations is dependent on our ability to raise additional financing to complete our program if warranted. As a result, our accountant believes there is substantial doubt about our ability to continue as a going concern.

We have accrued accumulated net losses of \$726,287 for the period from inception (April 11, 2005) to September 30, 2011. Our future is dependent upon our ability to obtain financing and upon future profitable operations from the development of our business. These factors raise substantial doubt that we will be able to continue as a going concern. Our independent auditors, has expressed substantial doubt about our ability to continue as a going concern. This opinion could materially limit our ability to raise additional funds by issuing new debt or equity securities or otherwise. If we fail to raise sufficient capital when needed, we will not be able to complete our business plan. As a result we may have to liquidate our business and you may lose your investment. You should consider our auditor's comments when determining if an investment in our company is suitable.

Because of the unique difficulties and uncertainties inherent in oil and gas ventures, we face a high risk of business failure.

You should be aware of the difficulties normally encountered by exploration companies and the high rate of failure of such enterprises. The likelihood of success must be considered in light of the problems, expenses, difficulties, complications and delays encountered in connection with the exploration and development of the properties that we plan to undertake. These potential problems include, but are not limited to, unanticipated problems relating to exploration, and additional costs and expenses that may exceed current estimates. If the results of our development program do not reveal viable commercialization options, we may decide to abandon our claim and acquire new claims. Our ability to acquire additional claims will be dependent upon our possessing adequate capital resources when needed. If no funding is available, we may be forced to abandon our operations.

Because of the inherent dangers involved in oil and gas operations, there is a risk that we may incur liability or damages as we conduct our business.

The extracting of oil and gas involves numerous hazards. As a result, we may become subject to liability for such hazards, including pollution, cave-ins and other hazards against which we cannot insure or against which we may elect not to insure. At the present time we have no insurance to cover against these hazards. The payment of such liabilities may result in our inability to complete our planned program and/or obtain additional financing to fund our program.

As we undertake development of our properties, we will be subject to compliance with government regulation that may increase the anticipated cost of our program.

There are several governmental regulations that materially restrict oil extraction. We will be subject to regulations and laws as we carry out our program. We may be required to obtain work permits, post bonds and perform remediation work for any physical disturbance to the area in order to comply with these laws. The cost of complying with permit and regulatory environment laws will be greater because the impact on the project area is greater.

Permits and regulations will control all aspects of the production program if the project continues to that stage. Examples of regulatory requirements can include:

- (a) Water discharge will have to meet drinking water standards;
- (b) Dust generation will have to be minimal or otherwise re-mediated;
- (c) Dumping of material on the surface will have to be re-contoured and re-vegetated with natural vegetation;
- (d) An assessment of all material to be left on the surface will need to be environmentally benign;
- (e) Ground water will have to be monitored for any potential contaminants;
- (f) The socio-economic impact of the project will have to be evaluated and if deemed negative, will have to be remediated; and

There is a risk that new regulations could increase our costs of doing business and prevent us from carrying out our exploration program. We will also have to sustain the cost of reclamation and environmental remediation for all exploration work undertaken. Both reclamation and environmental remediation refer to putting disturbed ground back as close to its original state as possible. Other potential pollution or damage must be cleaned-up and renewed along standard guidelines outlined in the usual permits. Reclamation is the process of bringing the land back to its natural state after completion of exploration activities. Environmental remediation refers to the physical activity of taking steps to remediate, or remedy, any environmental damage caused. The amount of these costs is not known at this time as we do not know the extent of the exploration program that will be undertaken beyond completion of the recommended work program. If remediation costs exceed our cash reserves we may be unable to complete our exploration program and have to abandon our operations.

If access to our properties is restricted by inclement weather, we may be delayed in any future mining efforts.

It is possible that adverse weather could cause accessibility to our properties difficult and this would delay in our timetables.

Based on consumer demand, the growth and demand for any oil or gas we may recover from our claims may be slowed, resulting in reduced revenues to the company.

Our success will be dependent on the growth of demand for petroleum products. If consumer demand slows our revenues may be significantly affected. This could limit our ability to generate revenues and our financial condition and operating results may be harmed.

Because our current officers and directors have other business interests, they may not be able or willing to devote a sufficient amount of time to our business operations, causing our business to fail.

Our current officers and directors currently devotes up to 10 hours per week providing services to the company. While they presently possess adequate time to attend to our interest, it is possible that the demands on them from other obligations could increase, with the result that they would no longer be able to devote sufficient time to the management of our business. This could negatively impact our business development.

WE MAY BE UNABLE TO OBTAIN ADDITIONAL CAPITAL THAT WE MAY REQUIRE TO IMPLEMENT OUR BUSINESS PLAN. THIS WOULD RESTRICT OUR ABILITY TO GROW.

The proceeds from our private offerings completed in 2007 and funds borrowed since this private offering, provide us with a limited amount of working capital and is not sufficient to fund our proposed operations. We will require

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additional capital to continue to operate our business and our proposed operations. We may be unable to obtain additional capital as and when required.

Future acquisitions and future development, production and marketing activities, as well as our administrative requirements (such as salaries, insurance expenses and general overhead expenses, as well as legal compliance costs and accounting expenses) will require a substantial amount of additional capital and cash flow.

We may not be successful in locating suitable financing transactions in the time period required or at all, and we may not obtain the capital we require by other means. If we do not succeed in raising additional capital, the capital we have received to date may not be sufficient to fund our operations going forward without obtaining additional capital financing.

Any additional capital raised through the sale of equity may dilute your ownership percentage. This could also result in a decrease in the fair market value of our equity securities because our assets would be owned by a larger pool of outstanding equity. The terms of securities we issue in future capital transactions may be more favorable to our new investors, and may include preferences, superior voting rights and the issuance of warrants or other derivative securities, and issuances of incentive awards under equity employee incentive plans, which may have a further dilutive effect.

Our ability to obtain needed financing may be impaired by such factors as the capital markets (both generally and in the resource industry in particular), our status as a new enterprise without a demonstrated operating history, the location of our properties and the price of oil and gas on the commodities markets (which will impact the amount of asset-based financing available to us) or the retention or loss of key management. Further, if oil and gas prices on the commodities markets decrease, then our revenues will likely decrease, and such decreased revenues may increase our requirements for capital. If the amount of capital we are able to raise from financing activities is not sufficient to satisfy our capital needs, we may be required to cease our operations.

We may incur substantial costs in pursuing future capital financing, including investment banking fees, legal fees, accounting fees, securities law compliance fees, printing and distribution expenses and other costs. We may also be required to recognize non-cash expenses in connection with certain securities we may issue, such as convertible notes and warrants, which may adversely impact our financial condition.

AMENDMENTS TO CURRENT LAWS AND REGULATIONS GOVERNING OUR PROPOSED OPERATIONS COULD HAVE A MATERIAL ADVERSE IMPACT ON OUR PROPOSED BUSINESS.

Our business will be subject to substantial regulation under state and federal laws relating to the exploration for, and the development, upgrading, marketing, pricing, taxation, and transportation of oil and other matters. Amendments to current laws and regulations governing operations and activities of resource operations could have a material adverse impact on our proposed business. In addition, there can be no assurance that income tax laws, royalty regulations and government incentive programs related to the resource industry generally, will not be changed in a manner which may adversely affect us and cause delays, inability to complete or abandonment of properties.

Permits, leases, licenses, and approvals are required from a variety of regulatory authorities at various stages of mining and extraction. There can be no assurance that the various government permits, leases, licenses and approvals sought will be granted to us or, if granted, will not be cancelled or will be renewed upon expiration.

ESTIMATES OF OIL RESERVES THAT WE MAKE MAY BE INACCURATE WHICH COULD HAVE A MATERIAL ADVERSE EFFECT ON US

There are numerous uncertainties inherent in estimating quantities of oil resources, including many factors beyond our control, and no assurance can be given that expected levels of resources or recovery of oil will be realized. In general, estimates of recoverable oil resources are based upon a number of factors and assumptions made as of the date on which resource estimates are determined, such as geological and engineering estimates which have inherent uncertainties and the assumed effects of regulation by governmental agencies and estimates of future commodity

prices and operating costs, all of which may vary considerably from actual results. All such estimates are, to some degree, uncertain and classifications of resources are only attempts to define the degree of uncertainty involved. For these reasons, estimates of the recoverable oil, the classification of such resources based on risk of recovery, prepared by different engineers or by the same engineers at different times, may vary substantially.

ABANDONMENT AND RECLAMATION COSTS ARE UNKNOWN AND MAY BE SUBSTANTIAL.

We will be responsible for compliance with terms and conditions of environmental and regulatory approvals and all laws and regulations regarding the abandonment of our properties and reclamation of lands at the end of their economic life, which abandonment and reclamation costs may be substantial. A breach of such legislation and/or regulations may result in the issuance of remedial orders, the suspension of approvals, or the imposition of fines and penalties, including an order for cessation of operations at the site until satisfactory remedies are made. It is not possible to estimate with certainty the abandonment and reclamation costs since they will be a function of regulatory requirements at the time.

INCREASES IN OUR OPERATING EXPENSES WILL IMPACT OUR OPERATING RESULTS AND FINANCIAL CONDITION.

Extraction, development, production, marketing (including distribution costs) and regulatory compliance costs (including taxes) will substantially impact the net revenues we derive from oil that we produce. These costs are subject to fluctuations and variation in different locales in which we will operate, and we may not be able to predict or control these costs. If these costs exceed our expectations, this may adversely affect our results of operations. In addition, we may not be able to earn net revenue at our predicted levels, which may impact our ability to satisfy our obligations.

PENALTIES WE MAY INCUR COULD IMPAIR OUR BUSINESS.

Failure to comply with government regulations could subject us to civil and criminal penalties, could require us to forfeit property rights, and may affect the value of our assets. We may also be required to take corrective actions, such as installing additional equipment or taking other actions, each of which could require us to make substantial capital expenditures. We could also be required to indemnify our employees in connection with any expenses or liabilities that they may incur individually in connection with regulatory action against them. As a result, our future business prospects could deteriorate due to regulatory constraints, and our profitability could be impaired by our obligation to provide such indemnification to our employees.

ENVIRONMENTAL RISKS MAY ADVERSELY AFFECT OUR BUSINESS.

Oil extraction operations present environmental risks and hazards and are subject to environmental regulation pursuant to a variety of federal, state, and local laws and regulations. Environmental legislation provides for, among other things, restrictions and prohibitions on spills, releases or emissions of various substances produced in association with resource operations. The legislation also requires that facility sites be operated, maintained, abandoned and reclaimed to the satisfaction of applicable regulatory authorities. Compliance with such legislation can require significant expenditures and a breach may result in the imposition of fines and penalties, some of which may be material. Environmental legislation is evolving in a manner we expect may result in stricter standards and enforcement, larger fines and liability and potentially increased capital expenditures and operating costs.

The discharge of pollutants into the air, soil or water may give rise to liabilities to governments and third parties and may require us to incur costs to remedy such discharges. The application of environmental laws to our business may cause us to curtail our production or increase the costs of our production, development or exploration activities.

CHALLENGES TO TITLE TO OUR PROPERTIES MAY IMPACT OUR FINANCIAL CONDITION.

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Title to oil interests is often not capable of conclusive determination without incurring substantial expense. While we intend to make appropriate inquiries into the title of properties and other development rights we acquire, title defects may exist. In addition, we may be unable to obtain adequate insurance for title defects, on a commercially reasonable basis or at all. If title defects do exist, it is possible that we may lose all or a portion of our right, title and interests in and to the properties to which the title defects relate.

THE LIMITED TRADING OF OUR COMMON STOCK ON THE OTC BULLETIN BOARD MAY IMPAIR YOUR ABILITY TO SELL YOUR SHARES.

There have been thin volumes of trading of our common stock. The lack of trading of our common stock and the low volume of any future trading may impair your ability to sell your shares at the time you wish to sell them or at a price that you consider reasonable. Such factors may also impair our ability to raise capital by selling shares of capital stock and may impair our ability to acquire other companies or technologies by using common stock as consideration.

THE MARKET PRICE OF OUR COMMON STOCK IS LIKELY TO BE HIGHLY VOLATILE AND SUBJECT TO WIDE FLUCTUATIONS.

Assuming we are able to establish an active trading market for our common stock, the market price of our common stock is likely to be highly volatile and could be subject to wide fluctuations in response to a number of factors that are beyond our control, including:

- * dilution caused by our issuance of additional shares of common stock and other forms of equity securities, which we expect to make in connection with future capital financings to fund our operations and growth, to attract and retain valuable personnel and in connection with future strategic partnerships with other companies;
- * announcements of acquisitions, reserve discoveries or other business initiatives by our competitors;
- * fluctuations in revenue from our business as new reserves come to market;
- * changes in the market for commodities or in the capital markets generally;
- * quarterly variations in our revenues and operating expenses;
- * changes in the valuation of similarly situated companies, both in our industry and in other industries;
- * changes in analysts' estimates affecting us, our competitors or our industry;
- * changes in the accounting methods used in or otherwise affecting our industry;
- * additions and departures of key personnel;
- * fluctuations in interest rates and the availability of capital in the capital markets; and

These and other factors are largely beyond our control, and the impact of these risks, singly or in the aggregate, may result in material adverse changes to the market price of our common stock and our results of operations and financial condition.

OUR OPERATING RESULTS MAY FLUCTUATE SIGNIFICANTLY, AND THESE FLUCTUATIONS MAY CAUSE OUR STOCK PRICE TO DECLINE.

Our operating results will likely vary in the future primarily as the result of fluctuations in our revenues and operating expenses, expenses that we incur, the price of oil and gas in the commodities markets and other factors. If our results of operations do not meet the expectations of current or potential investors, the price of our common stock may decline.

WE DO NOT EXPECT TO PAY DIVIDENDS IN THE FORESEEABLE FUTURE.

We do not intend to declare dividends for the foreseeable future, as we anticipate that we will reinvest any future earnings in the development and growth of our business. Therefore, investors will not receive any funds unless they sell their common stock, and stockholders may be unable to sell their shares on favorable terms or at all. Investors cannot be assured of a positive return on investment or that they will not lose the entire amount of their investment in the common stock.

APPLICABLE SEC RULES GOVERNING THE TRADING OF "PENNY STOCKS" WILL LIMIT THE TRADING AND LIQUIDITY OF OUR COMMON STOCK, WHICH MAY AFFECT THE TRADING PRICE OF OUR COMMON STOCK.

Our common stock is presently considered to be a "penny stock" and is subject to SEC rules and regulations which impose limitations upon the manner in which such shares may be publicly traded and regulate broker-dealer practices in connection with transactions in "penny stocks." Penny stocks generally are equity securities with a price of less than \$5.00 (other than securities registered on certain national securities exchanges or quoted on the NASDAQ system, provided that current price and volume information with respect to transactions in such securities is provided by the exchange or system). The penny stock rules require a broker-dealer, prior to a transaction in a penny stock not otherwise exempt from the rules, to deliver a standardized risk disclosure document that provides information about penny stocks and the risks in the penny stock market. The broker-dealer must also provide the customer with current bid and offer quotations for the penny stock, the compensation of the broker-dealer and its salesperson in the transaction, and monthly account statements showing the market value of each penny stock held in the customer's account. In addition, the penny stock rules generally require that prior to a transaction in a penny stock, the broker-dealer make a special written determination that the penny stock is a suitable investment for the purchaser and receive the purchaser's written agreement to the transaction. These disclosure requirements may have the effect of reducing the level of trading activity in the secondary market for a stock that becomes subject to the penny stock rules which may increase the difficulty investors may experience in attempting to liquidate such securities.

FORWARD-LOOKING STATEMENTS

This Form 10-Q contains forward-looking statements that involve risks and uncertainties. We use words such as anticipate, believe, plan, expect, future, intend and similar expressions to identify such forward-looking statements. You should not place too much reliance on these forward-looking statements. Our actual results are likely to differ materially from those anticipated in these forward-looking statements for many reasons.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

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

None.

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Item 5. Other Information

On December 18, 2008, Gregory Rotelli was appointed as our president, secretary, treasurer and director. Mr. Joe Arcaro was appointed on April 5, 2012 to become the sole director and officer of the Company. Mr. Arcaro has over 15 years' experience in the venture capital and securities industries.

Item 6. Exhibits

**Exhibit Description
Number**

(3) (i) Articles of Incorporation; and (ii) Bylaws

3.1 Articles of Incorporation (incorporated by reference from our Registration Statement on Form SB-2, filed on August 15, 2005).

3.2 Bylaws (incorporated by reference from our Registration Statement on Form SB-2, filed on August 15, 2005).

(10) Material Contracts

10.1 Master Franchise Agreement (incorporated by reference from our Registration Statement on Form SB-2, filed on August 15, 2005).

10.2 Turnkey Agreement between our company and Nitro Petroleum, Inc. (incorporated by reference from our Current Report on Form 8-K filed on April 4, 2008).

(14) Code of Ethics

14.1 Code of Ethics (incorporated by reference from our Annual Report on Form 10-KSB filed on September 26, 2008).

(31) Rule 13a-14(a)/15d-14(a) Certifications

31.1* Section 302 Certification under Sarbanes-Oxley Act of 2002

(32) Section 1350 Certifications

32.1* Section 906 Certification under Sarbanes-Oxley Act of 2002

* Filed herewith.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

TORO VENTURES INC.

By: /s/ Joseph Arcaro

Joseph Arcaro
(Principal Executive
Officer, Principal
Financial Officer and
Principal Accounting
Officer)
June 17, 2013

