

CommonWealth REIT  
Form 10-Q  
November 03, 2010  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, DC 20549

**FORM 10-Q**

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

For the quarterly period ended September 30, 2010

OR

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

Commission File Number 1-9317

**COMMONWEALTH REIT**

(Exact Name of Registrant as Specified in Its Charter)

Maryland

04-6558834

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(State or Other Jurisdiction of Incorporation or Organization)

(IRS Employer Identification No.)

**400 Centre Street, Newton, Massachusetts 02458**

(Address of Principal Executive Offices) (Zip Code)

**617-332-3990**

(Registrant's Telephone Number, Including Area Code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check One):

Large accelerated filer

Accelerated filer

Non-accelerated filer   
(Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

Number of registrant's common shares of beneficial interest, \$0.01 par value per share, outstanding as of November 1, 2010: 72,138,686

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### COMMONWEALTH REIT

### FORM 10-Q

September 30, 2010

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*References in this Form 10-Q to we, us and our refers to Commonwealth REIT and its consolidated subsidiaries, unless otherwise noted. All share amounts in this Form 10-Q give effect to the reverse stock split that resulted in a one for four combination of our common shares effective July 1, 2010.*



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## COMMONWEALTH REIT

## CONDENSED CONSOLIDATED BALANCE SHEETS

(amounts in thousands, except share data)

(unaudited)

	September 30, 2010	December 31, 2009
<b><u>ASSETS</u></b>		
Real estate properties:		
Land	\$ 1,238,611	\$ 1,237,808
Buildings and improvements	5,150,677	5,085,873
	6,389,288	6,323,681
Accumulated depreciation	(911,211)	(884,421)
	5,478,077	5,439,260
Properties held for sale	8,297	8,263
Acquired real estate leases, net	179,357	166,453
Equity investments	173,721	158,822
Cash and cash equivalents	174,723	18,204
Restricted cash	7,075	11,662
Rents receivable, net of allowance for doubtful accounts of \$12,415 and \$10,945, respectively	198,899	194,358
Other assets, net	153,626	124,299
Total assets	\$ 6,373,775	\$ 6,121,321
<b><u>LIABILITIES AND SHAREHOLDERS' EQUITY</u></b>		
Revolving credit facility	\$	\$ 110,000
Senior unsecured debt, net	2,474,116	2,258,466
Mortgage notes payable, net	352,575	624,184
Other liabilities related to properties held for sale	11	14
Accounts payable and accrued expenses	108,792	103,608
Acquired real estate lease obligations, net	43,513	47,348
Distributions payable		26,863
Rent collected in advance	32,418	30,366
Security deposits	22,903	23,097
Due to affiliates	25,602	8,309
Total liabilities	3,059,930	3,232,255
Shareholders' equity:		
Preferred shares of beneficial interest, \$0.01 par value:		

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50,000,000 shares authorized;

Series B preferred shares; 8 3/4% cumulative redeemable at par on or after September 12, 2007; 7,000,000 shares issued and outstanding, aggregate liquidation preference \$175,000	169,079	169,079
Series C preferred shares; 7 1/8% cumulative redeemable at par on or after February 15, 2011; 6,000,000 shares issued and outstanding, aggregate liquidation preference \$150,000	145,015	145,015
Series D preferred shares; 6 1/2% cumulative convertible; 15,180,000 shares issued and outstanding, aggregate liquidation preference \$379,500	368,270	368,270
Common shares of beneficial interest, \$0.01 par value:		
350,000,000 shares authorized; 72,138,686 and 55,965,061 shares issued and outstanding, respectively	721	560
Additional paid in capital	3,354,771	2,925,845
Cumulative net income	2,350,033	2,236,928
Cumulative common distributions	(2,639,887)	(2,576,582)
Cumulative preferred distributions	(420,597)	(382,596)
Cumulative other comprehensive (loss) income	(13,560)	2,547
Total shareholders' equity	3,313,845	2,889,066
Total liabilities and shareholders' equity	\$ 6,373,775	\$ 6,121,321

See accompanying notes

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COMMONWEALTH REIT

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(amounts in thousands, except per share data)

(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Rental income	\$ 218,035	\$ 206,032	\$ 644,725	\$ 634,577
Expenses:				
Operating expenses	93,722	87,881	271,664	265,486
Depreciation and amortization	48,520	48,042	147,869	145,787
General and administrative	10,658	9,607	30,888	28,844
Acquisition related costs	1,559	1,539	2,972	2,287
Total expenses	154,459	147,069	453,393	442,404
Operating income	63,576	58,963	191,332	192,173
Interest and other income	572	331	2,137	839
Interest expense (including amortization of debt discounts, premiums and deferred financing fees of \$1,839, \$1,574, \$5,644 and \$5,102, respectively)	(44,743)	(41,786)	(137,506)	(129,912)
Loss on asset impairment			(21,491)	
(Loss) gain on early extinguishment of debt	(1,044)		(1,044)	20,686
Equity in earnings of equity investments	1,999	2,957	6,643	3,818
Gain on issuance of shares by equity investee	18,390		34,808	
Gain on sale of properties	22,832		34,336	
Income from continuing operations before income tax expense	61,582	20,465	109,215	87,604
Income tax benefit (expense)	34	(176)	(329)	(518)
Income from continuing operations	61,616	20,289	108,886	87,086
Discontinued operations:				
(Loss) income from discontinued operations	(374)	1,804	(349)	8,684
Gain on sale of properties	4,568	50,106	4,568	79,157
Net income	65,810	72,199	113,105	174,927
Preferred distributions	(12,667)	(12,667)	(38,001)	(38,001)
Net income available for common shareholders	\$ 53,143	\$ 59,532	\$ 75,104	\$ 136,926
Weighted average common shares outstanding basic	65,173	55,932	62,198	56,085
Weighted average common shares outstanding diluted	72,471	63,230	69,496	63,383
Basic and diluted earnings per common share:				
Income from continuing operations available for common shareholders	\$ 0.75	\$ 0.14	\$ 1.14	\$ 0.88
Income from discontinued operations	\$ 0.06	\$ 0.93	\$ 0.07	\$ 1.57
Net income available for common shareholders	\$ 0.82	\$ 1.06	\$ 1.21	\$ 2.44

See accompanying notes



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## COMMONWEALTH REIT

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(amounts in thousands)

(unaudited)

	<b>Nine Months Ended September 30,</b>	
	<b>2010</b>	<b>2009</b>
<b>Cash flows from operating activities:</b>		
Net income	\$ 113,105	\$ 174,927
<b>Adjustments to reconcile net income to cash provided by operating activities:</b>		
Depreciation	117,575	116,412
Amortization of debt discounts, premiums and deferred financing fees	5,644	5,102
Amortization of acquired real estate leases	23,420	26,584
Other amortization	12,216	11,241
Loss on asset impairment	21,491	
Loss (gain) on early extinguishment of debt	1,044	(20,686)
Equity in earnings of equity investments	(6,643)	(3,818)
Gain on issuance of shares by equity investee	(34,808)	
Distributions of earnings from equity investments	6,660	
Gain on sale of properties	(38,904)	(79,157)
<b>Change in assets and liabilities:</b>		
Decrease (increase) in restricted cash	5,808	(801)
Increase in rents receivable and other assets	(36,581)	(20,525)
(Decrease) increase in accounts payable and accrued expenses	(10,951)	169
Increase in rent collected in advance	2,049	2,031
(Decrease) increase in security deposits	(59)	3,469
Increase in due to affiliates	17,293	18,644
Cash provided by operating activities	198,359	233,592
<b>Cash flows from investing activities:</b>		
Real estate acquisitions and improvements	(406,983)	(470,564)
Proceeds from investment in marketable pass through certificates	8,000	
Investment in marketable pass through certificates		(6,760)
Proceeds from sale of properties, net	230,911	212,057
Distributions in excess of earnings from equity investments	5,379	
Investment in Affiliates Insurance Company	(75)	(5,109)
Increase in restricted cash	(1,221)	
Cash used in investing activities	(163,989)	(270,376)
<b>Cash flows from financing activities:</b>		
Proceeds from issuance of common shares, net	430,778	
Repurchase and retirement of common shares		(14,486)
Repurchase and retirement of outstanding debt securities		(88,251)
Proceeds from borrowings	1,148,632	605,000
Payments on borrowings	(1,317,027)	(321,728)
Deferred financing fees	(9,565)	(7,026)
Distributions to common shareholders	(90,168)	(81,015)
Distributions to preferred shareholders	(38,001)	(38,001)

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Purchase of noncontrolling equity interest	(2,500)	
Cash provided by financing activities	122,149	54,493
Increase in cash and cash equivalents	156,519	17,709
Cash and cash equivalents at beginning of period	18,204	15,518
Cash and cash equivalents at end of period	\$ 174,723	\$ 33,227

See accompanying notes

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COMMONWEALTH REIT

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)

(amounts in thousands)

(unaudited)

	<b>Nine Months Ended September 30,</b>	
	<b>2010</b>	<b>2009</b>
<b>Supplemental cash flow information:</b>		
Interest paid	\$ 142,311	\$ 136,728
<b>Non-cash investing activities:</b>		
Real estate acquisitions	\$ (8,288)	\$ (9)
Investment in real estate mortgage receivable	(8,288)	
Net assets transferred to Government Properties Income Trust		395,317
<b>Non-cash financing activities:</b>		
Issuance of common shares	\$ 896	\$ 628
Secured credit facility and related deferred financing fees transferred to Government Properties Income Trust		(243,199)

See accompanying notes

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COMMONWEALTH REIT

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

**Note 1. Basis of Presentation**

The accompanying condensed consolidated financial statements of CommonWealth REIT, or CWH, we or us, and its subsidiaries have been prepared without audit. Certain information and footnote disclosures required by U.S. generally accepted accounting principles, or GAAP, for complete financial statements have been condensed or omitted. We believe the disclosures made are adequate to make the information presented not misleading. However, the accompanying condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes contained in our Annual Report on Form 10-K for the year ended December 31, 2009, or our Annual Report. In the opinion of our management, all adjustments, which include only normal recurring adjustments considered necessary for a fair presentation, have been included. All intercompany transactions and balances with our subsidiaries have been eliminated. Operating results for interim periods are not necessarily indicative of the results that may be expected for the full year. Reclassifications have been made to the prior years' financial statements to conform to the current year's presentation.

**Note 2. New Accounting Pronouncements**

In January 2010, the Financial Accounting Standards Board, or the FASB, issued an accounting standards update requiring additional disclosures regarding fair value measurements. The update requires entities to disclose additional information regarding assets and liabilities that are transferred between levels within the fair value hierarchy. The update also clarifies the level of disaggregation at which fair value disclosures should be made and the requirements to disclose information about the valuation techniques and inputs used in estimating Level 2 and Level 3 fair values. The update is effective for interim and annual reporting periods beginning after December 15, 2009 except for the requirement to separately disclose purchases, sales, issuances and settlements in the Level 3 roll forward that becomes effective for fiscal periods beginning after December 15, 2010.

The adoption of this update does not, and is not expected to, cause any material changes to the disclosures in our condensed consolidated financial statements.

**Note 3. Securities Held to Maturity**

Until August 2, 2010, we held \$8,000 of marketable commercial mortgage pass through certificates, or certificates, which were backed by our mortgage notes payable due January 2011 that were purchased in 2009 for \$6,760. We classified these certificates as investments held to maturity rather than available for sale or trading because we had the intent and ability to hold these certificates until maturity. We followed the amortized cost method of accounting for these certificates. Under this method, we amortized the difference between the face value of the

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certificates and their purchase price to income using the interest method over the expected remaining term of the certificates. As of December 31, 2009, these certificates had a carrying value of \$7,267 and were included in other assets in our consolidated balance sheet. As of December 31, 2009, these certificates had an estimated fair market value of \$7,443. On August 2, 2010, we prepaid the underlying mortgage notes payable, received \$8,000 from our investment in these certificates and recorded a gain of \$376 from the recognition of unamortized interest income. This gain is included in interest and other income in our condensed consolidated statements of income.

### **Note 4. Real Estate Properties**

Since January 1, 2010, we acquired 32 properties for aggregate purchase prices of \$552,625, excluding closing costs; we have also sold 16 properties for aggregate sales prices of \$240,750, excluding closing costs.

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COMMONWEALTH REIT

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(dollars in thousands, except per share data)

In April 2010, we acquired an office property located in Denver, CO with 248,493 square feet. The purchase price was \$75,000, excluding closing costs. We allocated \$4,720 to land, \$58,890 to buildings and improvements and \$11,390 to acquired real estate leases.

In April 2010, we acquired an office property located in Colorado Springs, CO with 77,411 square feet. The purchase price was \$10,800, excluding closing costs. We allocated \$1,250 to land, \$7,982 to buildings and improvements, \$1,576 to acquired real estate leases and \$8 to acquired real estate lease obligations.

In June 2010, we acquired two office properties located in Ann Arbor, MI with a combined 410,410 square feet. The aggregate purchase price was \$65,200, excluding closing costs. We allocated \$6,760 to land, \$46,988 to buildings and improvements, \$11,875 to acquired real estate leases and \$423 to acquired real estate lease obligations.

In June 2010, we acquired two office properties located in Carson, CA with a combined 212,000 square feet. The aggregate purchase price was \$27,925, excluding closing costs. We allocated \$7,460 to land, \$18,033 to buildings and improvements, \$3,415 to acquired real estate leases and \$983 to acquired real estate lease obligations.

In July 2010, we acquired two office properties located in Stafford, VA with a combined 117,949 square feet. The aggregate purchase price was \$18,750, excluding closing costs. We allocated \$1,929 to land, \$15,656 to buildings and improvements, \$1,182 to acquired real estate leases and \$17 to acquired real estate lease obligations.

In August 2010, we acquired one office property located in Milwaukee, WI with 432,092 square feet. The purchase price was \$80,200, excluding closing costs. We allocated \$3,150 to land, \$70,124 to buildings and improvements, \$7,795 to acquired real estate leases and \$869 to acquired real estate lease obligations.

In August 2010, we acquired seven properties located in Monterey, CA, consisting of approximately 1,155 acres of triple net leased agricultural land and related fixtures and improvements. The aggregate purchase price was \$28,000, excluding closing costs. We allocated \$9,657 to land and \$18,343 to fixtures and improvements based on currently available information. These preliminary allocations are subject to change pending an evaluation by an independent real estate appraisal firm that is expected to be finalized during the fourth quarter of 2010.

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In September 2010, we acquired one office property located in Greensboro, NC with 323,773 square feet. The purchase price was \$44,650, excluding closing costs. We allocated \$2,070 to land, \$37,073 to buildings and improvements, \$5,663 to acquired real estate leases and \$156 to acquired real estate lease obligations.

In October 2010, we acquired MacarthurCook Industrial Property Fund, an Australian property trust that owns 10 industrial properties with approximately 1,400,000 square feet. The purchase price for these properties was approximately \$83,200, excluding acquired positive working capital and closing costs.

In October 2010, we acquired three office properties located in Carson, CA with a combined 190,000 square feet. The aggregate purchase price was \$22,650, excluding closing costs.

In October 2010, we acquired a two tower office property located in Chicago, IL with 631,445 square feet. The purchase price was \$96,250, excluding closing costs.

In October 2010, we entered a purchase and sale agreement to acquire seven office properties located in Birmingham, AL with a combined 904,109 square feet. We expect to acquire these properties during the fourth quarter of 2010; however, this acquisition is subject to customary closing conditions and no assurance can be given that this acquisition will be consummated in that time period or at all.

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### COMMONWEALTH REIT

#### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(dollars in thousands, except per share data)

In June 2010, we entered agreements to sell 15 properties to our former subsidiary, Government Properties Income Trust, or GOV, that contain approximately 1,900,000 square feet for an aggregate sales price of \$231,000, excluding closing costs. All 15 of these properties have been sold as of September 30, 2010, and we recognized total gains of \$34,336, exclusive of deferred gains of \$14,588 attributable to our ownership interest in GOV. In addition, the net book value for four of these properties exceeded their allocated sales prices, and we recorded impairment charges of \$21,491 during the second quarter of 2010.

In September 2010, we sold an office property located in Irondequoit (Rochester), NY with approximately 310,000 square feet for \$9,750, excluding closing costs. In connection with this sale, we provided mortgage financing to the buyer, a not for profit hospital entity, totaling \$8,288 at 4.75% per annum and recognized a gain on sale of \$4,568 during the three months ended September 30, 2010.

During the nine months ended September 30, 2010, we funded \$43,599 of improvements to our owned properties.

As of September 30, 2010 and December 31, 2009, we had one office property located in Los Angeles, CA with approximately 79,000 square feet classified as held for sale in our consolidated balance sheets. This property was under contract for sale since June 2008; however, the purchase contract expired and we recognized the \$750 nonrefundable deposit previously paid by the buyer in other income when the buyer was unable to meet its obligation to close on January 26, 2010. We continue to actively market this property for sale.

We classify all properties actively marketed, under contract, in active negotiations or otherwise probable for sale within one year as held for sale in our consolidated balance sheets. Results of operations for properties sold or held for sale are included in discontinued operations in our consolidated statements of income, except for properties sold to GOV. Properties sold to GOV are not considered discontinued operations under GAAP because of our retained equity interest in this former subsidiary. Summarized balance sheet information for all properties classified as held for sale and income statement information for properties sold or held for sale, except for properties sold to GOV, is as follows:

#### Balance Sheets:

	September 30, 2010		December 31, 2009	
Real estate property, net	\$	8,195	\$	8,192
Other assets, net		102		71
Properties held for sale	\$	8,297	\$	8,263



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Rent collected in advance	\$	11	\$	14
Other liabilities related to properties held for sale	\$	11	\$	14

Income Statements:

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2010		2009		2010		2009	
Rental income	\$	23	\$	2,586	\$	1,070	\$	13,299
Operating expenses		(313)		(562)		(1,170)		(3,735)
Depreciation and amortization		(42)		(123)		(131)		(372)
General and administrative		(42)		(97)		(118)		(508)
(Loss) income from discontinued operations	\$	(374)	\$	1,804	\$	(349)	\$	8,684

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## COMMONWEALTH REIT

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(dollars in thousands, except per share data)

**Note 5. Equity Investments**

At September 30, 2010 and December 31, 2009, we had the following equity investments in GOV and Affiliates Insurance Company, or AIC:

	Ownership Percentage		Equity Investments		Equity in Earnings (Loss) Three Months Ended		Equity in Earnings (Loss) Nine Months Ended	
	September 30, 2010	December 31, 2009	September 30, 2010	December 31, 2009	September 30, 2010	September 30, 2009	September 30, 2010	September 30, 2009
GOV	24.6%	46.3%	\$ 168,663	\$ 153,822	\$ 1,964	\$ 2,980	\$ 6,660	\$ 3,950
AIC	14.3	14.3	5,058	5,000	35	(23)	(17)	(132)
			\$ 173,721	\$ 158,822	\$ 1,999	\$ 2,957	\$ 6,643	\$ 3,818

At September 30, 2010, we owned 9,950,000, or approximately 24.6%, of the common shares of beneficial interest of GOV, with a carrying value of \$168,663 and a market value, based on quoted market prices, of \$265,665 (\$26.70 per share). GOV is a real estate investment trust, or REIT, which owns properties that are majority leased to government tenants and was our wholly owned subsidiary until its initial public offering, or IPO, in June 2009 when it became a separate public entity. In January 2010, GOV issued 9,775,000 common shares in a public offering for \$21.50 per common share, raising net proceeds of approximately \$199,300. As a result of this transaction, our ownership percentage in GOV was reduced from 46.3% prior to this transaction to 31.8% after this transaction, and we recognized a gain of \$16,418. In August 2010, GOV issued an additional 9,200,000 common shares in a public offering for \$25.00 per common share, raising net proceeds of approximately \$219,900. As a result of this transaction, our ownership percentage in GOV was reduced from 31.8% prior to this transaction to 24.6% after this transaction, and we recognized a gain of \$18,390.

In connection with GOV's IPO, we and GOV entered into a transaction agreement in which, among other things, we granted GOV the right of first refusal to acquire any property owned by us that we determine to divest, if the property is then majority leased to a government tenant, including the 15 properties we sold to GOV during 2010. The sales for these 15 properties were negotiated by special committees of our and GOV's boards of trustees composed solely of independent trustees who are not also trustees of the other party.

Since GOV's IPO, our investment in it has been accounted for using the equity method. Under the equity method, we record our percentage share of net earnings of GOV in our consolidated statements of income. Prior to its IPO, the operating results and assets of GOV were included in our results of operations and balance sheet. If we determine there is an other than temporary decline in the fair value of this investment, we would record a charge to earnings.

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During the nine months ended September 30, 2010, we received cash distributions totaling \$12,039 from GOV.

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## COMMONWEALTH REIT

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(dollars in thousands, except per share data)

The following summarized financial data of GOV, as reported in its Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2010 includes results of operations prior to June 8, 2009 (the date GOV became a separate public company) which are included in our consolidated results of operations when GOV was our wholly owned subsidiary. References in our financial statements to the Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2010 for GOV are included as textual references only, and the information in GOV's Quarterly Report for the quarterly period ended September 30, 2010 is not incorporated by reference into our financial statements.

	September 30, 2010	December 31, 2009
Real estate properties, net	\$ 793,380	\$ 463,730
Acquired real estate leases, net	55,129	15,310
Cash and cash equivalents	2,314	1,478
Restricted cash	860	
Rents receivable, net	21,052	13,544
Other assets, net	25,846	20,751
Total assets	\$ 898,581	\$ 514,813
Mortgage notes payable	\$ 35,760	\$
Revolving credit facility	63,000	144,375
Acquired real estate lease obligations, net	11,419	3,566
Other liabilities	20,934	14,822
Shareholders' equity	767,468	352,050
Total liabilities and shareholders' equity	\$ 898,581	\$ 514,813

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Rental income	\$ 30,746	\$ 19,656	\$ 80,040	\$ 58,304
Operating expenses	(11,275)	(6,719)	(27,537)	(19,693)
Depreciation and amortization	(6,321)	(3,828)	(16,602)	(11,189)
Acquisition related costs	(2,687)	(207)	(4,542)	(207)
General and administrative	(1,833)	(1,216)	(4,909)	(2,829)
Operating income	8,630	7,686	26,450	24,386
Interest and other income	12	1	80	45
Interest expense	(1,973)	(1,472)	(5,182)	(3,832)
Equity in earnings (losses) of investee	35		(17)	
Income before income tax expense	6,704	6,215	21,331	20,599
Income tax expense	(35)	(30)	(77)	(30)
Net income	\$ 6,669	\$ 6,185	\$ 21,254	\$ 20,569
Weighted average common shares outstanding	36,369	21,455	32,265	12,852

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Net income per common share	\$	0.18	\$	0.29	\$	0.66	\$	1.60
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As of September 30, 2010, we have invested \$5,208 in AIC, an insurance company organized by Reit Management & Research LLC, or RMR, and companies to which RMR provides management services. All of our trustees serve on the board of directors of AIC. At September 30, 2010, we owned approximately 14.3% of the common shares of AIC, with a carrying value of \$5,058. Although we own less than 20% of AIC, we use the equity method to account for this investment because we believe that we have significant influence over AIC because each of our trustees is a director of AIC. Under the equity method, we record our percentage share of net earnings from AIC in our consolidated statements of income. If we determine there is an other than temporary decline in the fair value of this investment, we would record a charge to earnings. In evaluating the fair value of this investment, we

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COMMONWEALTH REIT

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(dollars in thousands, except per share data)

have considered, among other things, the assets and liabilities held by AIC, AIC's overall financial condition, and the financial condition and prospects for the insurance industry generally.

In June 2010, we, RMR and other companies to which RMR provides management services purchased property insurance pursuant to an insurance program arranged by AIC. Our annual premiums for this property insurance are expected to be approximately \$5,328. We are currently investigating the possibilities to expand our insurance relationships with AIC to include other types of insurance.

**Note 6. Real Estate Mortgage Receivable**

We provided mortgage financing for \$8,288 at 4.75% per annum in connection with an office property sold in September 2010. This real estate mortgage requires monthly principal and interest payments and matures on September 30, 2020. As of September 30, 2010, this mortgage had a carrying value of \$8,288 and was included in other assets in our condensed consolidated balance sheet.

**Note 7. Indebtedness**

In August 2010, we entered a new \$750,000 unsecured revolving credit facility that we use for acquisitions, working capital and general business purposes. The new facility replaces our previous \$750,000 unsecured revolving credit facility, which had a maturity date of August 22, 2010. The maturity date of the new facility is August 8, 2013 and includes an option for us to extend the facility for one year to August 8, 2014. The new facility also includes a feature under which the maximum borrowing may be increased to up to \$1,500,000 in certain circumstances. Interest paid under the new facility is set at LIBOR plus 200 basis points, subject to adjustments based on our credit ratings. The interest rate on our revolving credit facilities averaged 1.5% and 1.0% per annum for the nine months ended September 30, 2010 and 2009, respectively. As of September 30, 2010, we had zero outstanding and \$750,000 available under our new revolving credit facility.

In August 2010, we repaid at maturity all \$30,000 of our 8.875% senior notes due in 2010. We also prepaid at par \$266,674 of mortgage debt that was scheduled to mature in 2011 and 2029. In connection with the prepayment of this mortgage debt, we recorded a loss on early extinguishment of debt of \$1,044 from the write off of unamortized discounts and deferred financing fees during the third quarter of 2010. We funded these payments with borrowings under our revolving credit facility.

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In September 2010, we issued \$250,000 of unsecured senior notes in a public offering, raising net proceeds of approximately \$242,483. These notes bear interest at 5.875% per annum, require semi-annual interest payments and mature in September 2020. Net proceeds from these notes were used to repay amounts then outstanding under our revolving credit facility.

Our public debt indentures and credit facility agreement contain a number of financial and other covenants, including a credit facility covenant which restricts our ability to make distributions under certain circumstances. At September 30, 2010, we believe that we are in compliance with these financial and other covenants.

At September 30, 2010, 15 of our properties costing \$598,225 with an aggregate net book value of \$493,032 were secured by \$352,575 of mortgage debt maturing between 2011 and 2027.

In October 2010, we repaid at maturity, all \$20,000 of our 8.625% senior notes due in 2010 using cash on hand.

### **Note 8. Shareholders Equity**

During the nine months ended September 30, 2010, we issued 16,125,000 common shares in two public offerings, raising net proceeds of \$430,778.

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## COMMONWEALTH REIT

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(dollars in thousands, except per share data)

Other comprehensive income includes unrealized gains or losses on the fair value of our interest rate swap agreements and other investments. Our interest rate swap agreements qualify as cash flow hedges and convert the floating interest rate on a \$175,000 mortgage note payable to a fixed interest rate. The following is a reconciliation of net income to total comprehensive income for the three and nine months ended September 30, 2010 and 2009:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Comprehensive income:				
Net income	\$ 65,810	\$ 72,199	\$ 113,105	\$ 174,927
Unrealized loss on derivative instrument	(5,150)		(15,965)	
Unrealized loss on investment in available for sale securities	(141)		(141)	
Total comprehensive income	\$ 60,519	\$ 72,199	\$ 96,999	\$ 174,927

On April 14, 2010, we issued 1,250 common shares, valued at \$32.44 per share, the closing price of our common shares on the New York Stock Exchange, or NYSE, on that day, to each of our five trustees as part of their annual compensation. On September 17, 2010, pursuant to our equity compensation plan, we granted an aggregate of 42,375 common shares of beneficial interest, par value \$0.01 per share, valued at \$27.30 per share, the closing price of our common shares on the NYSE, on that day, to our officers and certain employees of our manager, RMR.

On June 14, 2010, our board of trustees approved a reverse stock split that resulted in a one for four combination of our common shares of beneficial interest, \$0.01 par value per share, effective July 1, 2010. The reverse stock split reduced the number of our issued and outstanding common shares from 258,385,241 to 64,596,311. The number of our authorized common shares did not change. As required, common share amounts presented for all periods have been restated to reflect the reverse stock split. As a result of the reverse stock split, the conversion rate of our 15,180,000 outstanding series D cumulative convertible preferred shares, or series D preferred shares, automatically changed from 1.9231 common shares per series D preferred share to 0.480775 common share per series D preferred share (the equivalent of a change in conversion price from \$13.00 per common share to \$52.00 per common share).



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## COMMONWEALTH REIT

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(dollars in thousands, except per share data)

**Note 9. Fair Value of Assets and Liabilities**

The table below presents certain of our assets and liabilities measured at fair value at September 30, 2010, categorized by the level of inputs used in the valuation of each asset and liability:

Description	Total	Fair Value at Reporting Date Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Properties held for sale (1)	\$ 8,195	\$	\$ 8,195	\$
Effective portion of interest rate contracts (2)	\$ (13,418)	\$	\$ (13,418)	\$
Investment in available for sale securities (3)	\$ 407	\$ 407	\$	\$

(1) Properties held for sale are reported at the lower of carrying value or fair value less costs to sell and consists of one property that we expect to sell within one year. We used our estimate of fair value less estimated closing costs to determine the fair value of this property (level 2 inputs).

(2) The fair value of our interest rate swap contracts is determined using the net discounted cash flows of the expected cash flows of each derivative based on the market based interest rate curve (level 2 inputs) and adjusted for our credit spread and the actual and estimated credit spreads of the counterparties (level 3 inputs). Although we have determined that the majority of the inputs used to value our derivatives fall within level 2 of the fair value hierarchy, the credit valuation adjustments associated with our derivatives utilize level 3 inputs, such as estimates of current credit spreads, to evaluate the likelihood of default by us and the counterparties. As of September 30, 2010, we have assessed the significance of the impact of the credit valuation adjustments on the overall valuation of our derivative positions and have determined that the credit valuation adjustments are not significant to the overall valuation of our derivatives. As a result, we have determined that our derivative valuations in their entirety are classified as level 2 inputs in the fair value hierarchy.

(3) The fair value of our investment in available for sale securities is based on quoted prices at September 30, 2010 in active markets (level 1 inputs) and is included in other assets in our condensed consolidated balance sheet.

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We are exposed to certain risks relating to our ongoing business operations. The primary risk managed by using our derivative instruments is interest rate risk. We enter into interest rate swaps to manage interest rate risk associated with our floating rate borrowings. We have interest rate swap agreements to manage our interest rate risk exposure on \$175,000 of mortgage notes due 2019, which require interest at a spread over LIBOR. The interest rate swap agreements utilized by us qualify as cash flow hedges and effectively modify our exposure to interest rate risk by converting our floating interest rate debt to a fixed interest rate basis for this loan through December 1, 2016, thus reducing the impact of interest rate changes on future interest expense. These agreements involve the receipt of floating interest rate amounts in exchange for fixed rate interest payments over the life of the agreements without an exchange of the underlying principal amount. The fair value of our derivative instruments decreased by \$5,150 and \$15,965 during the three and nine months ended September 30, 2010, respectively, based primarily on changes in market interest rates. As of September 30, 2010, the fair value of these derivative instruments included in accounts payable and accrued expenses and cumulative other comprehensive income (loss) in our consolidated balance sheet totaled (\$13,418). As of December 31, 2009, the fair value of these derivative instruments included in other assets and cumulative other comprehensive income (loss) in our consolidated balance sheet totaled \$2,547.

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## COMMONWEALTH REIT

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(dollars in thousands, except per share data)

In addition to the assets and liabilities described in the above table, our financial instruments include our cash and cash equivalents, rents receivable, equity investments, real estate mortgage receivable, marketable pass through certificates, restricted cash, revolving credit facility, senior notes and mortgage notes payable, accounts payable and other accrued expenses, rent collected in advance, security deposits and amounts due to affiliates. At September 30, 2010 and December 31, 2009, the fair values of these additional financial instruments were not materially different from their carrying values, except as follows:

	September 30, 2010		December 31, 2009	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Equity investment in GOV	\$ 168,663	\$ 265,665	\$ 153,822	\$ 228,651
Marketable pass through certificates	\$	\$	\$ 7,267	\$ 7,443
Senior notes and mortgage notes payable	\$ 2,483,472	\$ 2,640,614	\$ 2,539,431	\$ 2,547,036

At September 30, 2010 and December 31, 2009, the fair values of our equity investment in GOV are based on quoted market prices of \$26.70 and \$22.98, respectively. At December 31, 2009, the fair values of our marketable pass through certificates are based on quoted market prices of \$93.04. The fair values of our senior notes and mortgage notes payable are based on estimates using discounted cash flow analyses and currently prevailing interest rates adjusted by credit risk spreads.

Other financial instruments that potentially subject us to concentrations of credit risk consist principally of rents receivable; however, none of our tenants are responsible for more than 2% of our total rents.

**Note 10. Earnings Per Common Share**

The effect of our convertible preferred shares on income from continuing operations available for common shareholders per share is anti-dilutive for the periods presented.

**Note 11. Segment Information**

As of September 30, 2010, we owned 285 suburban office properties, 41 central business district, or CBD, office properties and 193 industrial & other properties, excluding one property classified as held for sale and included in discontinued operations. We account for all of these

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properties in geographic operating segments for financial reporting purposes based on our method of internal reporting. We account for our properties by property type (i.e. suburban office, CBD office and industrial & other) and by geographic regions. We define these individual geographic segments as those which currently, or during either of the last two quarters, represent or generate 5% or more of our total square feet, revenues or property net operating income, or NOI, which we define as rental income less property level operating expenses. Prior periods have been restated to reflect one office property reclassified from discontinued operations during the fourth quarter of 2009 and one office property reclassified from continuing operations during the third quarter of 2010. Property level information as of and for the three and nine months ended September 30, 2010 and 2009, excluding discontinued operations, is as follows:

	As of September 30, 2010				As of September 30, 2009			Totals
	Suburban Office	CBD Office	Industrial & Other	Totals	Suburban Office	CBD Office	Industrial & Other	
Property square feet (in thousands):								
Metro Philadelphia, PA	700	4,592		5,292	701	4,584		5,285
Oahu, HI			17,914	17,914			17,914	17,914
Metro Denver, CO	788	672	553	2,013	539	670	548	1,757
Metro Washington, DC	1,067	428		1,495	1,287	582		1,869
Metro Boston, MA	2,003	390		2,393	2,101	523		2,624
Other markets	17,603	6,755	13,041	37,399	16,869	6,756	12,696	36,321
Totals	22,161	12,837	31,508	66,506	21,497	13,115	31,158	65,770

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(dollars in thousands, except per share data)

	Three Months Ended September 30, 2010				Three Months Ended September 30, 2009			
	Suburban Office	CBD Office	Industrial & Other	Totals	Suburban Office	CBD Office	Industrial & Other	Totals
Property rental income:								
Metro Philadelphia, PA	\$ 2,828	\$ 27,920	\$	\$ 30,748	\$ 2,733	\$ 28,753	\$	\$ 31,486
Oahu, HI			18,114	18,114			18,872	18,872
Metro Denver, CO	3,778	5,238	2,124	11,140	1,333	5,271	1,948	8,552
Metro Washington, DC	7,471	4,284		11,755	7,505	3,801		11,306
Metro Boston, MA	7,087	4,797		11,884	7,313	5,401		12,714
Other markets	74,032	41,081	19,281	134,394	67,920	37,855	17,327	123,102
Totals	\$ 95,196	\$ 83,320	\$ 39,519	\$ 218,035	\$ 86,804	\$ 81,081	\$ 38,147	\$ 206,032

Property net operating income:								
Metro Philadelphia, PA	\$ 1,191	\$ 14,112	\$	\$ 15,303	\$ 1,123	\$ 15,336	\$	\$ 16,459
Oahu, HI			13,542	13,542			13,729	13,729
Metro Denver, CO	2,773	3,409	1,201	7,383	638	3,544	1,141	5,323
Metro Washington, DC	4,372	2,747		7,119	4,711	2,231		6,942
Metro Boston, MA	4,384	1,691		6,075	4,404	2,496		6,900
Other markets	40,331	21,089	13,471	74,891	37,559	19,765	11,474	68,798
Totals	\$ 53,051	\$ 43,048	\$ 28,214	\$ 124,313	\$ 48,435	\$ 43,372	\$ 26,344	\$ 118,151

	Nine Months Ended September 30, 2010				Nine Months Ended September 30, 2009			
	Suburban Office	CBD Office	Industrial & Other	Totals	Suburban Office	CBD Office	Industrial & Other	Totals
Property rental income:								
Metro Philadelphia, PA	\$ 8,336	\$ 84,165	\$	\$ 92,501	\$ 8,045	\$ 84,660	\$	\$ 92,705
Oahu, HI			54,457	54,457			54,622	54,622
Metro Denver, CO	8,999	15,715	6,233	30,947	7,026	5,594	5,932	18,552
Metro Washington, DC	22,371	14,655		37,026	27,866	18,077		45,943
Metro Boston, MA	21,425	14,943		36,368	22,148	16,407		38,555
Other markets	214,954	121,607	56,865	393,426	221,757	110,442	52,001	384,200
Totals	\$ 276,085	\$ 251,085	\$ 117,555	\$ 644,725	\$ 286,842	\$ 235,180	\$ 112,555	\$ 634,577

Property net operating income:								
Metro Philadelphia, PA	\$ 3,359	\$ 43,066	\$	\$ 46,425	\$ 3,384	\$ 44,379	\$	\$ 47,763
Oahu, HI			40,569	40,569			41,598	41,598
Metro Denver, CO	6,399	10,526	3,592	20,517	4,206	3,733	3,505	11,444
Metro Washington, DC	13,028	9,803		22,831	17,645	10,883		28,528
Metro Boston, MA	13,268	6,872		20,140	13,210	8,111		21,321
Other markets	119,437	63,300	39,842	222,579	125,885	58,055	34,497	218,437

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Totals	\$	155,491	\$	133,567	\$	84,003	\$	373,061	\$	164,330	\$	125,161	\$	79,600	\$	369,091
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## COMMONWEALTH REIT

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(dollars in thousands, except per share data)

The following table reconciles our calculation of NOI to net income, the most directly comparable financial measure under GAAP reported in our consolidated financial statements. We consider NOI to be appropriate supplemental information to net income because it helps both investors and management to understand the operations of our properties. We use NOI internally as a performance measure and believe NOI provides useful information to investors regarding our results of operations because it reflects only those income and expense items that are incurred at the property level. Our management also uses NOI to evaluate individual, regional and company wide property level performance. NOI excludes certain components from net income in order to provide results that are more closely related to our properties' results of operations. NOI does not represent cash generated by operating activities in accordance with GAAP and should not be considered an alternative to net income, net income available for common shareholders or cash flow from operating activities as a measure of financial performance. A reconciliation of NOI to net income for the three and nine months ended September 30, 2010 and 2009, is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Rental income	\$ 218,035	\$ 206,032	\$ 644,725	\$ 634,577
Operating expenses	(93,722)	(87,881)	(271,664)	(265,486)
Property net operating income (NOI)	\$ 124,313	\$ 118,151	\$ 373,061	\$ 369,091
Property NOI	\$ 124,313	\$ 118,151	\$ 373,061	\$ 369,091
Depreciation and amortization	(48,520)	(48,042)	(147,869)	(145,787)
General and administrative	(10,658)	(9,607)	(30,888)	(28,844)
Acquisition related costs	(1,559)	(1,539)	(2,972)	(2,287)
Operating income	63,576	58,963	191,332	192,173
Interest and other income	572	331	2,137	839
Interest expense	(44,743)	(41,786)	(137,506)	(129,912)
Loss on asset impairment			(21,491)	
(Loss) gain on early extinguishment of debt	(1,044)		(1,044)	20,686
Equity in earnings of equity investments	1,999	2,957	6,643	3,818
Gain on issuance of shares by equity investee	18,390		34,808	
Gain on sale of properties	22,832		34,336	
Income from continuing operations before income tax expense	61,582	20,465	109,215	87,604
Income tax benefit (expense)	34	(176)	(329)	(518)
Income from continuing operations	61,616	20,289	108,886	87,086
(Loss) income from discontinued operations	(374)	1,804	(349)	8,684
Gain on sale of properties from discontinued operations	4,568	50,106	4,568	79,157
Net income	\$ 65,810	\$ 72,199	\$ 113,105	\$ 174,927

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COMMONWEALTH REIT

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(dollars in thousands, except per share data)

**Note 12. Related Person Transactions**

As discussed in Note 5, we own 9,950,000, or approximately 24.6%, of the common shares of beneficial interest of GOV, with a carrying value of \$168,663 and a market value, based on quoted market prices, of \$265,665 (\$26.70 per share) as of September 30, 2010. GOV is a REIT which owns properties that are majority leased to government tenants and was our wholly owned subsidiary until its IPO in June 2009 when it became a separate publicly owned entity. We and GOV are both managed by RMR and both our Managing Trustees are also Managing Trustees of GOV.

In June 2010, we entered agreements to sell 15 properties to GOV that contain approximately 1,900,000 square feet. We sold all 15 of these properties for an aggregate sales price of \$231,000, excluding closing costs. In connection with GOV's IPO, we and GOV entered into a transaction agreement in which, among other things, we granted GOV the right of first refusal to acquire any property owned by us that we determine to divest, if the property is then majority leased to a government tenant, including these 15 properties. These transactions were negotiated by special committees of our and GOV's boards of trustees composed solely of Independent Trustees who are not also trustees of the other party.

In connection with our business management agreement with RMR, we recognized expenses of \$8,881 and \$8,322 for the three months ended September 30, 2010 and 2009, respectively, and \$26,053 and \$25,266 for the nine months ended September 30, 2010 and 2009, respectively. These amounts are included in general and administrative expenses and income (loss) from discontinued operations in our condensed consolidated financial statements. In connection with our property management agreement with RMR, we recognized property and construction management fees of \$6,592 and \$6,321 for the three months ended September 30, 2010 and 2009, respectively, and \$19,878 and \$22,129 for the nine months ended September 30, 2010 and 2009, respectively. The property and construction management fees are included in operating expenses or have been capitalized, as appropriate, in our condensed consolidated financial statements.

As of September 30, 2010, we have invested \$5,208 in AIC with RMR and other companies to which RMR provides management services. All of our trustees serve on the board of directors of AIC. At September 30, 2010, we owned approximately 14.3% of AIC. Also, RMR provides certain management services to AIC. Although we own less than 20% of AIC, we use the equity method to account for this investment because we believe that we have significant influence over AIC because each of our trustees is a director of AIC. This investment is carried on our condensed consolidated balance sheets in equity investments and had a carrying value of \$5,058 and \$5,000 as of September 30, 2010 and December 31, 2009, respectively. During the three and nine months ended September 30, 2010, we invested an additional \$31 and \$75, respectively, in AIC. During the three and nine months ended September 30, 2010, we recognized earnings and (losses) of \$35 and (\$17), respectively, related to this investment. In June 2010, we, RMR and other companies to which RMR provides management services purchased property insurance pursuant to an insurance program arranged by AIC. Our annual premiums for this property insurance are expected to be approximately \$5,328. We are currently investigating the possibilities to expand our insurance relationships with AIC to include other types of insurance.



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For more information about our related person transactions, including our dealings with GOV, RMR, AIC and our Managing Trustees and their affiliates, and about the risks which may arise as a result of these and other related person transactions, please see our Annual Report and our other filings made with the Securities and Exchange Commission, or the SEC, and in particular the sections captioned "Risk Factors" and "Management's Discussion and Analysis of Financial Condition and Results of Operations - Related Person Transactions" in our Annual Report and the section captioned "Related Person Transactions and Company Review of Such Transactions" in our Proxy Statement dated February 23, 2010 relating to our 2010 Annual Meeting of Shareholders and Item 1.01 in our Current Report on Form 8-K dated January 27, 2010 and our Current Report on Form 8-K filed with the SEC on June 18, 2010.

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COMMONWEALTH REIT

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(dollars in thousands, except per share data)

**Note 13. Subsequent Events**

In October 2010, we redeemed the remaining 7,000,000 shares of our 8 <sup>3</sup>/<sub>4</sub>% series B preferred shares for \$25.00 per share plus accrued and unpaid distributions, using borrowings under our revolving credit facility.

In October 2010, we declared a distribution of \$0.50 per common share, or approximately \$36,100, to be paid on or about November 22, 2010 to shareholders of record on October 22, 2010. Prior to the July 1, 2010 one for four reverse stock split, regular quarterly distributions were \$0.12 per share per quarter (\$0.48 per share per year). We also have announced a distribution on our series C preferred shares of \$0.4453 per share, or \$2,672, and a distribution on our series D preferred shares of \$0.4063 per share, or \$6,167, which we expect to pay on or about November 15, 2010 to our preferred shareholders of record as of November 1, 2010. Other subsequent events have been disclosed within other notes to this Quarterly Report on Form 10-Q.

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

The following discussion should be read in conjunction with our condensed consolidated financial statements and notes thereto included in this Quarterly Report on Form 10-Q and our Annual Report.

**OVERVIEW**

We primarily own office and industrial buildings in suburban and CBD locations throughout the United States. We also own 17.9 million square feet of leased industrial and commercial lands located in Oahu, Hawaii.

***Property Operations***

As of September 30, 2010, 86.4% of our total square feet was leased, compared to 88.2% leased as of September 30, 2009. These results reflect a 2.6 percentage point decrease in occupancy at properties we owned continuously since January 1, 2009. Occupancy data for 2010 and 2009 is as follows (square feet in thousands):

	All Properties (1)		Comparable Properties (2)	
	As of September 30,		For the Nine Months Ended September 30,	
	2010	2009	2010	2009
Total properties	519	515	491	491
Total square feet	66,506	65,770	61,455	61,455
Percent leased (3)	86.4%	88.2%	85.6%	88.2%

- 
- (1) Excludes properties classified in discontinued operations as of September 30, 2010.  
(2) Based on properties owned continuously since January 1, 2009, and excludes properties sold or classified in discontinued operations as of September 30, 2010.  
(3) Percent leased includes (i) space being fitted out for occupancy pursuant to signed leases and (ii) space which is leased but is not occupied or is being offered for sublease by tenants.

During the three months ended September 30, 2010, we signed lease renewals for 1,287,000 square feet and new leases for 733,000 square feet that had weighted average rental rates that were 3% above rents previously charged for the same space. Average lease terms for leases signed during the three months ended September 30, 2010 were 5.8 years. Commitments for tenant improvement and leasing costs for leases signed during the three months ended September 30, 2010 totaled \$26.3 million, or \$13.04 per square foot on average (approximately \$2.25/sq. ft. per year of the lease term).

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During the past twelve months, leasing market conditions in the majority of our markets have stabilized, but remain weak. As a result, the amount of leasing activity within our portfolio has slowed and our occupancy has declined. Required landlord funded tenant build outs and leasing commissions payable to tenant brokers for new leases and lease renewals have increased in certain markets since the second half of 2008. These build out costs and leasing commissions are generally amortized as a reduction of our income during the terms of the affected leases. We believe that the current high unemployment rate and weak leasing market conditions in the U.S. may lead to a continued decrease in occupancy and effective rents at our properties through the end of 2010, but we expect our occupancy may begin to improve in 2011. However, there are too many variables for us to reasonably project what the financial impact of changing market conditions will be on our occupancy or financial results for future periods.

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Approximately 15.4% of our leased square feet and 15.1% of our rents are included in leases scheduled to expire through December 31, 2011. Lease renewals and rental rates at which available space may be relet in the future will depend on prevailing market conditions at the times these renewals and rates are negotiated. Lease expirations by year, as of September 30, 2010, are as follows (square feet and dollars in thousands):

Year	Square Feet Expiring (1)	% of Square Feet Expiring	Cumulative % of Square Feet Expiring	Annualized Rental Income Expiring (2)	% of Annualized Rental Income Expiring	Cumulative % of Annualized Rental Income Expiring
2010	3,623	6.3%	6.3%	\$ 47,072	5.4%	5.4%
2011	5,259	9.1%	15.4%	84,719	9.7%	15.1%
2012	5,464	9.5%	24.9%	103,295	11.9%	27.0%
2013	5,696	9.9%	34.8%	100,713	11.5%	38.5%
2014	4,490	7.8%	42.6%	77,599	8.9%	47.4%
2015	3,657	6.4%	49.0%	77,927	9.0%	56.4%
2016	3,329	5.8%	54.8%	56,147	6.5%	62.9%
2017	2,923	5.1%	59.9%	77,712	8.9%	71.8%
2018	2,256	4.0%	63.9%	52,366	6.0%	77.8%
2019	3,467	6.0%	69.9%	42,571	4.9%	82.7%
Thereafter	17,316	30.1%	100.0%	150,212	17.3%	100.0%
	57,480	100.0%		\$ 870,333	100.0%	
Weighted average remaining lease term (in years):						
	7.8			5.8		

- (1) Square feet is pursuant to signed leases as of September 30, 2010 and includes (i) space being fitted out for occupancy and (ii) space which is leased, but is not occupied or is being offered for sublease by tenants. Excludes properties classified in discontinued operations.
- (2) Rents are pursuant to signed leases as of September 30, 2010, plus estimated expense reimbursements; includes some triple net lease rents and excludes lease value amortization. Excludes properties classified in discontinued operations.

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Our principal source of funds for our operations is rents from tenants at our properties. Rents are generally received from our tenants monthly in advance, except from our government tenants, who pay rents monthly in arrears. As of September 30, 2010, tenants responsible for 1% or more of our total rent were as follows (square feet in thousands):

Tenant	Square Feet (1)	% of Total Square Feet (1)	% of Rent (2)	Expiration
1.Expédia, Inc.	349	0.6%	2.0%	2018
2.PNC Financial Services Group	613	1.1%	1.8%	2011 to 2021
3.John Wiley & Sons, Inc.	342	0.6%	1.8%	2017
4.GlaxoSmithKline plc	608	1.1%	1.7%	2013
5.U. S. Government (3)	470	0.8%	1.6%	2010 to 2021
6.Wells Fargo Bank	477	0.8%	1.4%	2010 to 2017
7.Jones Day (law firm)	407	0.7%	1.2%	2012, 2019
8.The Bank of New York Mellon Corp.	390	0.7%	1.1%	2011, 2012, 2015, 2020
9.Ballard Spahr Andrews & Ingersoll (law firm)	269	0.5%	1.1%	2011, 2012, 2015
10.Flextronics International Ltd.	894	1.6%	1.1%	2014
11.JDA Software Group, Inc.	283	0.5%	1.1%	2012
12.ING	410	0.7%	1.1%	2011, 2018
13 Towers Watson	334	0.6%	1.0%	2010 to 2020
Total	5,846	10.3%	18.0%	

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- (1) Square feet is pursuant to signed leases as of September 30, 2010 and includes (i) space being fitted out for occupancy and (ii) space which is leased but is not occupied or is being offered for sublease by tenants. Excludes properties classified in discontinued operations.
- (2) Rent is pursuant to signed leases as of September 30, 2010, plus estimated expense reimbursements. Includes some triple net lease rents and excludes lease value amortization. Excludes properties classified in discontinued operations.
- (3) Including our 24.6% pro rata ownership of GOV as of September 30, 2010, the U.S. Government represents 1,723 square feet, or 2.9% of total square feet, and 4.7% of total rental income.

### **Investment Activities**

Since January 1, 2010, we acquired 32 office and industrial properties with 4.1 million square feet for \$552.6 million, excluding closing costs. At the time of acquisition, these properties were 91.6% leased at rents which yielded approximately 9.7% of the aggregate gross purchase price, based on estimated annual NOI on the date of closing.

In January 2010, GOV issued 9,775,000 common shares in a public offering for \$21.50 per common share, raising net proceeds of approximately \$199.3 million. In August 2010, GOV issued an additional 9,200,000 common shares in a public offering for \$25.00 per common share, raising net proceeds of approximately \$219.9 million. As a result of these transactions, our ownership percentage in GOV was reduced from 46.3% prior to these transactions to 24.6% after these transactions, and we recognized gains totaling \$34.8 million.

In June 2010, we entered agreements to sell 15 properties to GOV that contain approximately 1.9 million square feet for an aggregate sales price of \$231.0 million, excluding closing costs. All 15 of these properties have been sold as of September 30, 2010, and we recognized total gains of \$34.3 million, exclusive of deferred gains of \$14.6 million attributable to our ownership interest in GOV. The net book value for four of these

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properties exceeded their allocated sales prices, and we recorded impairment charges of \$21.5 million during the second quarter of 2010.

In September 2010, we sold an office property located in Irondequoit (Rochester), NY with approximately 310,000 square feet for \$9.8 million, excluding closing costs. In connection with this sale, we provided mortgage financing to the buyer, a not for profit hospital entity, totaling \$8.3 million at 4.75% per annum and recognized a gain on sale of \$4.6 million during the three months ended September 30, 2010.

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*Financing Activities*

In March and September 2010, we issued 8,625,000 and 7,500,000 common shares, respectively, in public offerings, raising net proceeds aggregating \$430.8 million. We used the net proceeds from these offerings to repay amounts then outstanding under our revolving credit facility and for general business purposes, including property acquisitions and debt repayments.

In August 2010, we entered a new \$750.0 million unsecured revolving credit facility that we use for acquisitions, working capital and general business purposes. The new facility replaces our previous \$750.0 million unsecured revolving credit facility which had a maturity date of August 22, 2010. The maturity date of the new facility is August 8, 2013, and includes an option for us to extend the facility for one year to August 8, 2014. The new facility also includes a feature under which the maximum borrowing may be increased to up to \$1.5 billion in certain circumstances. Interest paid under the new facility is set at LIBOR plus 200 basis points, subject to adjustments based on our credit ratings.

In August 2010, we repaid at maturity all \$30.0 million of our 8.875% senior notes due 2010. We also prepaid at par \$266.7 million of mortgage debt that was scheduled to mature in 2011 and 2029. We funded these payments with borrowings under our revolving credit facility.

In September 2010, we issued \$250.0 million of unsecured senior notes in a public offering, raising net proceeds of approximately \$242.5 million. These notes bear interest at 5.875% per annum, require semi-annual interest payments and mature in September 2020. Net proceeds from these notes were used to repay amounts then outstanding under our revolving credit facility.

In October 2010, we repaid at maturity all \$20.0 million of our 8.625% senior notes due in 2010 using cash on hand.

In October 2010, we redeemed the remaining 7,000,000 shares of our 83/4% series B preferred shares for \$25.00 per share plus accrued and unpaid distributions, using borrowings under our revolving credit facility.



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**RESULTS OF OPERATIONS**

*Three Months Ended September 30, 2010, Compared to Three Months Ended September 30, 2009*

	2010	2009	\$ Change	% Change
	(in thousands, except per share data)			
Rental income	\$ 218,035	\$ 206,032		