PS BUSINESS PARKS INC/CA
Form 10-K
February 20, 2015

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2014.

or

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

For the transition period from to

Commission File Number 1-10709

PS BUSINESS PARKS, INC.

(Exact name of registrant as specified in its charter)

California	**95-4300881**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*

701 Western Avenue, Glendale, California 91201-2349

(Address of principal executive offices) (Zip Code)

818-244-8080

(Registrant s telephone number, including area code)

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

Title of Each Class	**Name of Each Exchange on Which Registered**
Common Stock, $0.01 par value per share	New York Stock Exchange
Depositary Shares Each Representing 1/1,000 of a Share of	New York Stock Exchange

6.875% Cumulative Preferred Stock, Series R, $0.01 par value per share	
Depositary Shares Each Representing 1/1,000 of a Share of	
6.450% Cumulative Preferred Stock, Series S, $0.01 par value per share	New York Stock Exchange
Depositary Shares Each Representing 1/1,000 of a Share of	
6.000% Cumulative Preferred Stock, Series T, $0.01 par value per share	New York Stock Exchange
Depositary Shares Each Representing 1/1,000 of a Share of	
5.750% Cumulative Preferred Stock, Series U, $0.01 par value per share	New York Stock Exchange
Depositary Shares Each Representing 1/1,000 of a Share of	
5.700% Cumulative Preferred Stock, Series V, $0.01 par value per share	New York Stock Exchange

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

None

(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes þ No ¨

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes ¨ No þ

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 þ 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 þ No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§232.405) is not contained herein, and will not be contained, to the best of the 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. þ

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 definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer þ	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 þ

As of June 30, 2014, the aggregate market value of the registrant s common stock held by non-affiliates of the registrant was $1,625,742,494 based on the closing price as reported on that date.

Number of shares of the registrant s common stock, par value $0.01 per share, outstanding as of February 16, 2015 (the latest practicable date): 26,919,161.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive proxy statement to be filed in connection with the Annual Meeting of Shareholders to be held in 2015 are incorporated by reference into Part III of this Annual Report on Form 10-K.

PART I

ITEM 1. *BUSINESS*

Forward-Looking Statements

Forward-looking statements, within the meaning of the Private Securities Litigation Reform Act of 1995, are made throughout this Annual Report on Form 10-K. For this purpose, any statements contained herein that are not statements of historical fact may be deemed to be forward-looking statements. Without limiting the foregoing, the words may, believes, anticipates, plans, expects, seeks, estimates, in similar expressions are intended to identify forward-looking statements. There are a number of important factors that could cause the results of the Company to differ materially from those indicated by such forward-looking statements, including but not limited to: (a) changes in general economic and business conditions; (b) decreases in rental rates or increases in vacancy rates/failure to renew or replace expiring leases; (c) tenant defaults; (d) the effect of the recent credit and financial market conditions; (e) our failure to maintain our status as a real estate investment trust (REIT); (f) the economic health of our tenants; (g) increases in operating costs; (h) casualties to our properties not covered by insurance; (i) the availability and cost of capital; (j) increases in interest rates and its effect on our stock price; (k) other factors discussed under the heading Item 1A, Risk Factors . In light of the significant uncertainties inherent in the forward-looking statements included herein, the inclusion of such information should not be regarded as a representation by us or any other person that our objectives and plans will be achieved. Moreover, we assume no obligation to update these forward-looking statements to reflect actual results, changes in assumptions or changes in other factors affecting such forward-looking statements, except as required by law.

The Company

PS Business Parks, Inc. (PSB) is a fully-integrated, self-advised and self-managed REIT that owns, operates, acquires and develops commercial properties, primarily multi-tenant flex, office and industrial parks. PS Business Parks, L.P. (the Operating Partnership) is a California limited partnership, which owns directly or indirectly substantially all of our assets and through which we conduct substantially all of our business. Unless otherwise indicated or unless the context requires otherwise, all references to the Company, we, us, our, and similar references mean PS Business Parks, Inc. and its subsidiaries, including the Operating Partnership. PSB is the sole general partner of the Operating Partnership and, as of December 31, 2014, owned 77.8% of the common partnership units. The remaining common partnership units are owned by Public Storage (PS). Assuming issuance of PSB common stock upon redemption of the common partnership units held by PS, PS would own 42.3% (or 14.5 million shares) of the outstanding shares of the Company s common stock. PSB, as the sole general partner of the Operating Partnership, has full, exclusive and complete responsibility and discretion in managing and controlling the Operating Partnership.

As of December 31, 2014, the Company owned and operated 28.6 million rentable square feet of commercial space, comprising 103 business parks, concentrated primarily in the following states: California, Florida, Maryland, Texas, Virginia and Washington. The Company focuses on owning concentrated business parks which provide the Company with the greatest flexibility to meet the needs of its customers. The Company also manages 1.1 million rentable square feet on behalf of PS.

History of the Company: The Company was formed in 1990 as a California corporation under the name Public Storage Properties XI, Inc. In a March 17, 1998 merger with American Office Park Properties, Inc. (AOPP) (the Merger), the Company acquired the commercial property business operated by AOPP and was renamed PS Business Parks, Inc. Prior to the Merger, in January, 1997, AOPP was reorganized to succeed to the commercial property business of PS, becoming a fully integrated, self-advised and self-managed REIT.

From January, 2012 through December, 2014, the Company acquired 3.4 million square feet of multi-tenant flex, office and industrial parks, which comprise the Non-Same Park portfolio as defined on page 30, for an aggregate purchase price of $213.6 million. The table below reflects the assets acquired during this period *(in thousands)*:

Property	Date Acquired	Location	Purchase Price	Square Feet	Occupancy at December 31, 2014
Charcot Business Park II	December, 2014	San Jose, California	$ 16,000	119	96.7%
McNeil 1	November, 2014	Austin, Texas	10,550	246	53.3%
Springlake Business Center II	August, 2014	Dallas, Texas	5,148	145	39.6%
Arapaho Business Park 9	July, 2014	Dallas, Texas	1,134	19	100.0%
MICC Center 23	July, 2014	Miami, Florida	12,725	149	100.0%
Total 2014 Acquisitions			45,557	678	69.5%
Bayshore Corporate Center	December, 2013	San Mateo, California	60,500	340	84.8%
Valwood Business Park	November, 2013	Dallas, Texas	12,425	245	88.3%
Dallas Flex Portfolio	October, 2013	Dallas, Texas	27,900	559	77.5%
Arapaho Business Park	July, 2013	Dallas, Texas	14,750	389	87.7%
Total 2013 Acquisitions			115,575	1,533	83.5%
Austin Flex Buildings	December, 2012	Austin, Texas	14,900	226	100.0%
212th Business Park	July, 2012	Kent Valley, Washington	37,550	958	91.6%
Total 2012 Acquisitions			52,450	1,184	93.2%
Total			$ 213,582	3,395	84.2%

At the beginning of 2013, the Company reclassified a 125,000 square foot building located in Northern Virginia to land and building held for development as the Company intends to redevelop the property. In conjunction with the reclassification, the Company ceased depreciation of the asset. In July, 2013, the Company entered into a joint venture agreement, which it will maintain a 95.0% economic interest in, with a real estate development company to pursue a multi-family development on the property. During the entitlement phase, all costs related to the pre-development will be split evenly between the Company and its joint venture partner. Subsequent to December 31, 2014, the Company received entitlements which allow it to develop a multi-family building up to 450,000 square feet on the property. The property will be contributed to the joint venture upon commencement of construction, which will occur in 2015. The asset and capitalized development costs were $18.4 million and $16.2 million at December 31, 2014 and December 31, 2013, respectively, which includes the Company s basis in the land. For the years ended December 31, 2014 and 2013, the Company capitalized costs of $2.2 million and $752,000, respectively, related to this development, of which $944,000 and $359,000, respectively, related to capitalized interest costs.

On November 21, 2014, the Company completed the sale of three business parks, consisting of 42 buildings aggregating 656,000 square feet, located in Phoenix, Arizona, for net proceeds of $52.2 million, resulting in a net gain of $29.6 million.

On October 1, 2014, the Company completed the sale of two business parks, Cornell Oaks Corporate Center and Creekside Corporate Park along with 11.5 acres of adjacent land, located in Beaverton, Oregon, for net proceeds of $159.9 million, resulting in a net gain of $62.8 million. The parks consist of 18 buildings aggregating 1.2 million square feet.

In October, 2012, the Company completed the sale of Quail Valley Business Park, a 66,000 square foot flex park in Houston, Texas, for a gross sales price of $2.3 million, resulting in a net gain of $935,000.

From 1998 through 2011, the Company acquired 23.7 million square feet of commercial space, developed an additional 575,000 square feet and sold 2.2 million square feet along with some parcels of land.

As of December 31, 2014, the Company has 125,000 square feet of assets held for sale which the Company expects to sell in 2015.

The Company has elected to be taxed as a REIT under the Internal Revenue Code of 1986, as amended (the Code), commencing with its taxable year ended December 31, 1990. To the extent that the Company continues to qualify as a REIT, it will not be taxed, with certain limited exceptions, on the net income that is currently distributed to its shareholders.

The Company s principal executive offices are located at 701 Western Avenue, Glendale, California 91201-2349. The Company s telephone number is (818) 244-8080. The Company maintains a website with the address www.psbusinessparks.com. The information contained on the Company s website is not a part of, or incorporated by reference into, this Annual Report on Form 10-K. The Company makes available free of charge through its website its Annual Report on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K, and amendments to these reports, as soon as reasonably practicable after the Company electronically files such material with, or furnishes such material to, the Securities and Exchange Commission (the SEC).

Business of the Company: The Company is in the commercial property business, with 103 business parks consisting of multi-tenant flex, industrial and office space. The Company owns 15.1 million square feet of flex space. The Company defines flex space as buildings that are configured with a combination of warehouse and office space and can be designed to fit a wide variety of uses. The warehouse component of the flex space has a number of uses including light manufacturing and assembly, storage and warehousing, showroom, laboratory, distribution and research and development activities. The office component of flex space is complementary to the warehouse component by enabling businesses to accommodate management and production staff in the same facility. The Company owns 8.8 million square feet of industrial space that has characteristics similar to the warehouse component of the flex space as well as ample dock access. In addition, the Company owns 4.6 million square feet of low-rise office space, generally either in business parks that combine office and flex space or in submarkets where the market demand is more office focused.

The Company s commercial properties typically consist of business parks with low-rise buildings, ranging from one to 49 buildings per park, located on parcels of various sizes which comprise from nearly 12,000 to 3.5 million aggregate square feet of rentable space. Facilities are managed through either on-site management or offices central to the facilities. Parking is generally open but in some instances is covered. The ratio of parking spaces to rentable square feet ranges from two to six per thousand square feet depending upon the use of the property and its location. Office space generally requires a greater parking ratio than most industrial uses. The Company may acquire properties that do not have these characteristics.

The tenant base for the Company s facilities is diverse. The portfolio can be bifurcated into those facilities that service small to medium-sized businesses and those that service larger businesses. Approximately 35.6% of in-place rents from the portfolio are derived from facilities that serve small to medium-sized businesses. A property in this facility type is typically divided into units ranging in size from 500 to 4,999 square feet and leases generally range from one to three years. The remaining 64.4% of in-place rents from the portfolio are derived from facilities that serve larger businesses, with units greater than or equal to 5,000 square feet. The Company also has several tenants that lease space in multiple buildings and locations. The U.S. Government is the largest tenant with multiple leases encompassing approximately 845,000 square feet or 5.9% of the Company s annualized rental income.

The Company currently owns operating properties concentrated primarily in six states and it may expand its operations to other states or reduce the number of states in which it operates. Properties are acquired for both income and potential capital appreciation; there is no limitation on the amount that can be invested in any specific property.

The Company owns land which may be used for the development of commercial properties. The Company owns approximately 14.0 acres of such land in Dallas, Texas and 6.4 acres in Northern Virginia as of December 31, 2014.

Operating Partnership

The properties in which the Company has an equity interest generally are owned by the Operating Partnership. Through this organizational structure, the Company has the ability to acquire interests in additional properties in transactions that could defer the contributors tax consequences by causing the Operating Partnership to issue equity interests in return for interests in properties.

The Company is the sole general partner of the Operating Partnership. As of December 31, 2014, the Company owned 77.8% of the common partnership units of the Operating Partnership, and the remainder of such common partnership units were owned by PS. The common units owned by PS may be redeemed by PS from time to time, subject to the provisions of our charter, for cash or, at our option, shares of our common stock on a one-for-one basis. Also as of December 31, 2014, in connection with the Company s issuance of publicly traded Cumulative Preferred Stock, the Company owned 39.8 million preferred units of the Operating Partnership of various series with an aggregate redemption value of $995.0 million with terms substantially identical to the terms of the publicly traded depositary shares each representing 1/1,000 of a share of 5.700% to 6.875% Cumulative Preferred Stock of the Company.

As the general partner of the Operating Partnership, the Company has the exclusive responsibility under the Operating Partnership Agreement to manage and conduct the business of the Operating Partnership. The Board of Directors directs the affairs of the Operating Partnership by managing the Company s affairs. The Operating Partnership is responsible for, and pays when due, its share of all administrative and operating expenses of the properties it owns.

The Company s interest in the Operating Partnership entitles it to share in cash distributions from, and the profits and losses of, the Operating Partnership in proportion to the Company s economic interest in the Operating Partnership (apart from tax allocations of profits and losses to take into account pre-contribution property appreciation or depreciation). The Company, since 1998, has paid per share dividends on its common and preferred stock that track, on a one-for-one basis, the amount of per unit cash distributions the Company receives from the Operating Partnership in respect of the common and preferred partnership units in the Operating Partnership that are owned by the Company.

Common Officers and Directors with PS

Ronald L. Havner, Jr., Chairman of the Company, is also the Chairman of the Board, Chief Executive Officer and President of PS. Gary E. Pruitt, an independent director of the Company is also a trustee of PS. Other employees of PS render services to the Company pursuant to the cost sharing and administrative services agreement.

Property Management Services

The Company manages commercial properties owned by PS, which are generally adjacent to self-storage facilities, for a management fee of 5% of the gross revenues of such properties in addition to reimbursement of direct costs. The property management contract with PS is for a seven-year term with the agreement automatically extending for an additional one-year period upon each one-year anniversary of its commencement (unless cancelled by either party). Either party can give notice of its intent to cancel the agreement upon expiration of its current term. Management fee revenue derived from this management contract with PS totaled $660,000, $639,000 and $649,000 for the years ended December 31, 2014, 2013 and 2012, respectively.

PS also provides property management services for the self-storage component of two assets owned by the Company. These self-storage facilities, located in Palm Beach County, Florida, operate under the Public Storage name. Either the Company or PS can cancel the property management contract upon 60 days notice. Management fee expenses under the contract were $70,000, $59,000 and $55,000 for the years ended December 31, 2014, 2013 and 2012, respectively.

Management

Joseph D. Russell, Jr. leads the Company s senior management team. Mr. Russell is President and Chief Executive Officer of the Company. The Company s senior management includes: John W. Petersen, Executive Vice President and Chief Operating Officer; Edward A. Stokx, Executive Vice President and Chief Financial Officer; Maria R. Hawthorne, Executive Vice President and Chief Administrative Officer; Christopher M. Auth, Vice President (Washington Metro Division); Trenton A. Groves, Vice President and Corporate Controller; Coby A. Holley, Vice President, Acquisitions and Dispositions; Robin E. Mather, Vice President (Southern California Division); Eddie F. Ruiz, Vice President and Director of Facilities; Viola I. Sanchez, Vice President (Southeast Division); Richard E. Scott, Vice President (Northern California Division); Eugene Uhlman, Vice President, Construction Management; and David A. Vicars, Vice President (Midwest Division).

REIT Structure

If certain detailed conditions imposed by the Code and the related Treasury Regulations are met, an entity, such as the Company, that invests principally in real estate and that otherwise would be taxed as a corporation may elect to be treated as a REIT. The most important consequence to the Company of being treated as a REIT for federal income tax purposes is that the Company can deduct dividend distributions (including distributions on preferred stock) to its shareholders, thus effectively eliminating the double taxation (at the corporate and shareholder levels) that typically results when a corporation earns income and distributes that income to shareholders in the form of dividends.

The Company believes that it has operated, and intends to continue to operate, in such a manner as to qualify as a REIT under the Code, but no assurance can be given that it will at all times so qualify. To the extent that the Company continues to qualify as a REIT, it will not be taxed, with certain limited exceptions, on the taxable income that is distributed to its shareholders.

Operating Strategy

The Company believes its operating, acquisition and finance strategies combined with its diversified portfolio produces a low risk, stable growth business model. The Company s primary objective is to grow shareholder value. Key elements of the Company s growth strategy include:

Maximize Net Cash Flow of Existing Properties: The Company seeks to maximize the net cash flow generated by its properties by (i) maximizing average occupancy rates, (ii) achieving the highest possible levels of realized rents per occupied square foot, (iii) controlling its operating cost structure by improving operating efficiencies and economies of scale and (iv) minimizing recurring capital expenditures required to maintain and improve occupancy. The Company believes that its experienced property management personnel and comprehensive systems combined with increasing economies of scale enhance the Company s ability to meet these goals. The Company seeks to increase occupancy rates and realized rents per square foot by providing its field personnel with incentives to lease space to credit tenants and to maximize the return on investment in each lease transaction.

Focus on Targeted Markets: The Company intends to continue investing in markets that have characteristics which enable them to be competitive economically. The Company believes that markets with some combination of above average population growth, job growth, higher education levels and personal income will produce better overall economic returns. The Company targets parks in high barrier to entry markets that are close to critical infrastructure, middle to high income housing or universities and have easy access to major transportation arteries.

Reduce Capital Expenditures and Increase Occupancy Rates by Providing Flexible Properties and Attracting a Diversified Tenant Base: By focusing on properties with easily reconfigurable space, the Company believes it can offer facilities that appeal to a wide range of potential tenants, which aids in reducing the capital expenditures associated with re-leasing space. The Company believes this property flexibility also allows it to better serve existing tenants by accommodating expansion and contraction needs. In addition, the Company believes that a diversified tenant base combined with flexible parks helps it maintain occupancy rates by enabling it to attract a greater number of potential users to its space.

Provide Superior Property Management: The Company seeks to provide a superior level of service to its tenants in order to maintain occupancy and increase rental rates, as well as minimize customer turnover. The Company s property management offices are located either on-site or regionally, providing tenants with convenient access to management and helping the Company maintain its properties and while conveying a sense of quality, order and security. The Company has significant experience in acquiring properties managed by others and thereafter improving tenant satisfaction, occupancy levels, retention rates and rental income by implementing established tenant service programs.

Financing Strategy

The Company s primary objective in its financing strategy is to maintain financial flexibility and a low risk capital structure. Key elements of this strategy are:

Retain Operating Cash Flow: The Company seeks to retain significant funds (after funding its distributions and capital improvements) for additional investments. During the years ended December 31, 2014 and 2013, the Company distributed 42.3% and 34.3%, respectively, of its funds from operations (FFO) to common shareholders/unit holders. FFO is computed in accordance with the White Paper on FFO approved by the Board of Governors of the National Association of Real Estate Investment Trusts (NAREIT). The White Paper defines FFO as net income, computed in accordance with U.S. generally accepted accounting principles (GAAP), before depreciation, amortization, gains or losses on asset dispositions, net income allocable to noncontrolling interests common units, net income allocable to restricted stock unit holders, impairment charges and nonrecurring items. FFO is a non-GAAP financial measure and should be analyzed in conjunction with net income. However, FFO should not be viewed as a substitute for net income as a measure of operating performance as it does not reflect depreciation and amortization costs or the level of capital expenditure and leasing costs necessary to maintain the operating performance of the Company s properties, which are significant economic costs and could materially impact the Company s results of operations. Other REITs may use different methods for calculating FFO and, accordingly, the Company s FFO may not be comparable to other real estate companies funds from operations. See Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources Non-GAAP Supplemental Disclosure Measure: Funds from Operations, for a reconciliation of FFO and net income allocable to common shareholders and for additional information on why the Company presents FFO.

Perpetual Preferred Stock/Units: The primary source of leverage in the Company s capital structure is perpetual preferred stock or equivalent preferred units in the Operating Partnership. This method of financing eliminates interest rate and refinancing risks as the dividend rate is fixed and the stated value or capital contribution is not required to be repaid. In addition, the consequences of defaulting on required preferred distributions are less severe than with debt. The preferred shareholders may elect two additional directors if six quarterly distributions go unpaid, whether or not consecutive.

Throughout this Form 10-K, we use the term preferred equity to mean both the preferred stock issued by the Company (including the depositary shares representing interests in that preferred stock) and the preferred partnership units issued by the Operating Partnership and the term preferred distributions to mean dividends and distributions on the preferred stock and preferred partnership units.

Debt Financing: The Company, from time to time, has used debt financing to facilitate real estate acquisitions and other capital allocations. The primary source of debt the Company has historically relied upon to provide short-term capital is its $250.0 million unsecured line of credit (the Credit Facility). In addition, during 2011, in connection with its $520.0 million portfolio acquisition in Northern California, the Company obtained a $250.0 million unsecured three-year term loan and assumed a $250.0 million mortgage note. During 2013, the Company repaid the remaining balance of $200.0 million on the unsecured three-year term loan. The $250.0 million mortgage note is an interest only mortgage that matures December, 2016.

Access to Capital: The Company targets a minimum ratio of FFO to combined fixed charges and preferred distributions paid of 3.0 to 1.0. Fixed charges include interest expense and capitalized interest while preferred distributions include amounts paid to preferred shareholders and preferred Operating Partnership unit holders. For the year ended December 31, 2014, the FFO to combined fixed charges and preferred distributions paid ratio was 3.2 to 1.0. The Company believes that its financial position enables it to access capital to finance future growth. Subject to market conditions, the Company may add leverage to its capital structure.

Competition

Competition in the market areas in which many of the Company s properties are located is significant and has from time to time reduced the occupancy levels and rental rates of, and increased the operating expenses of, certain of these properties. Competition may be accelerated by any increase in availability of funds for investment in real estate. Barriers to entry are relatively low for those with the necessary capital and the

Company competes for property acquisitions and tenants with entities that have greater financial resources than the Company. Sublease space and unleased developments are expected to continue to provide competition among operators in certain markets in which the Company operates. While the Company will have to respond to market demands, management believes that the combination of its ability to offer a variety of options within its business parks and the Company s financial stability provide it with an opportunity to compete favorably in its markets.

The Company s properties compete for tenants with similar properties located in its markets primarily on the basis of location, rent charged, services provided and the design and condition of improvements. The Company believes it possesses several distinguishing characteristics that enable it to compete effectively in the flex, office and industrial space markets. The Company believes its personnel are among the most experienced in these real estate markets. The Company s facilities are part of a comprehensive system encompassing standardized procedures and integrated reporting and information networks. The Company believes that the significant operating and financial experience of its executive officers and directors combined with the Company s capital structure, national investment scope, geographic diversity and economies of scale should enable the Company to compete effectively.

Investments in Real Estate Facilities

As of December 31, 2014, the Company owned and operated 28.6 million rentable square feet comprised of 103 business parks concentrated primarily in six states compared to 29.7 million rentable square feet at December 31, 2013.

Summary of Business Model

The Company has a diversified portfolio. It is diversified geographically primarily in six states across the country and has a diversified customer mix by size and industry concentration. The Company believes that this diversification combined with a conservative financing strategy, focus on markets with strong demographics for growth and our operating strategy gives the Company a business model that mitigates risk and provides strong long-term growth opportunities.

Restrictions on Transactions with Affiliates

The Company s Bylaws provide that the Company may engage in transactions with affiliates provided that a purchase or sale transaction with an affiliate is (i) approved by a majority of the Company s independent directors and (ii) fair to the Company based on an independent appraisal or fairness opinion.

Borrowings

The Company had an outstanding mortgage note payable of $250.0 million at December 31, 2014 and 2013. See Notes 5 and 6 to the consolidated financial statements included in this Form 10-K for a summary of the Company s outstanding borrowings as of December 31, 2014.

On April 28, 2014, the Company modified and extended the terms of its line of credit (the Credit Facility) with Wells Fargo Bank, National Association (Wells Fargo). The expiration of the Credit Facility was extended from August 1, 2015 to May 1, 2019. The Credit Facility has a borrowing limit of $250.0 million. The rate of interest charged on borrowings was modified to a rate ranging from the London Interbank Offered Rate (LIBOR) plus 0.875% to LIBOR plus 1.70% depending on the Company s credit ratings. Currently, the Company s rate under the Credit Facility is LIBOR plus 0.925%. In addition, the Company is required to pay an annual facility fee ranging from 0.125% to 0.30% of the borrowing limit depending on the Company s credit ratings (currently 0.15%). The Company had no balance outstanding on the Credit Facility at December 31, 2014 and 2013. The Company had $1.0 million and $485,000 of unamortized commitment fees as of December 31, 2014 and 2013, respectively. The Credit Facility requires the Company to meet certain covenants, with all of which the Company was in compliance at December 31, 2014 and 2013. Interest on outstanding borrowings is payable monthly.

The Company had a term loan with Wells Fargo (the Term Loan) in the amount of $250.0 million that was scheduled to mature on December 31, 2014. The Term Loan was repaid in full in November, 2013. Interest on the amounts borrowed under the Term Loan was accrued based on an applicable rate ranging from LIBOR plus 1.15% to LIBOR plus 2.25% depending on the Company s credit ratings. During 2013, the Company s rate under the Term Loan was LIBOR plus 1.20%.

The Company has broad powers to borrow in furtherance of the Company s objectives. The Company has incurred in the past, and may incur in the future, both short-term and long-term indebtedness to facilitate real estate acquisitions and other capital allocations.

Employees

As of December 31, 2014, the Company employed 168 individuals, primarily personnel engaged in property operations.

Insurance

The Company believes that its properties are adequately insured. Facilities operated by the Company have historically been covered by comprehensive insurance, including fire, earthquake and liability coverage from nationally recognized carriers.

Environmental Matters

Compliance with laws and regulations relating to the protection of the environment, including those regarding the discharge of material into the environment, has not had any material effect upon the capital expenditures, earnings or competitive position of the Company.

Substantially all of the Company s properties have been subjected to Phase I environmental reviews. Such reviews have not revealed, nor is management aware of, any probable or reasonably possible environmental costs that management believes would have a material adverse effect on the Company s business, assets or results of operations, nor is the Company aware of any potentially material environmental liability. See Item 1A, Risk Factors for additional information.

ITEM 1A. ***RISK FACTORS***

In addition to the other information in our Annual Report on Form 10-K, you should consider the risks described below that we believe may be material to investors in evaluating the Company. This section contains forward-looking statements, and in considering these statements, you should refer to the qualifications and limitations on our forward-looking statements that are described in Item 1, Business Forward-Looking Statements.

Since our business consists primarily of acquiring and operating real estate, we are subject to the risks related to the ownership and operation of real estate that can adversely impact our business and financial condition.

The value of our investments may be reduced by general risks of real estate ownership: Since we derive substantially all of our income from real estate operations, we are subject to the general risks of acquiring and owning real estate-related assets, including:

- changes in the national, state and local economic climate and real estate conditions, such as oversupply of or reduced demand for commercial real estate space and changes in market rental rates;

- how prospective tenants perceive the attractiveness, convenience and safety of our properties;

- difficulties in consummating and financing acquisitions and developments on advantageous terms and the failure of acquisitions and developments to perform as expected;

- our ability to provide adequate management, maintenance and insurance;

- natural disasters, such as earthquakes, hurricanes and floods, which could exceed the aggregate limits of our insurance coverage;

the expense of periodically renovating, repairing and re-letting spaces;

the impact of environmental protection laws;

- compliance with federal, state, and local laws and regulations;
- increasing operating and maintenance costs, including property taxes, insurance and utilities, if these increased costs cannot be passed through to tenants;
- adverse changes in tax, real estate and zoning laws and regulations;
- increasing competition from other commercial properties in our market;
- tenant defaults and bankruptcies;
- tenants right to sublease space; and
- concentration of properties leased to non-rated private companies with uncertain financial strength.

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

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

There is significant competition among commercial properties: Other commercial properties compete with our properties for tenants. Some of the competing properties may be newer and better located than our properties. Competition in the market areas in which many of our properties are located is significant and has affected our occupancy levels, rental rates and operating expenses. We also expect that new properties will be built in our markets. In addition, we compete with other buyers, some of which are larger than us, for attractive commercial properties. Therefore, we may not be able to grow as rapidly as we would like.

We may encounter significant delays and expense in re-letting vacant space, or we may not be able to re-let space at existing rates, in each case resulting in losses of income: When leases expire, we may incur expenses in retrofitting space and we may not be able to re-lease the space on the same terms. Certain leases provide tenants with the right to terminate early if they pay a fee. As of December 31, 2014, 2,318 leases representing 27.4% of the leased square footage of our total portfolio or 25.7% of annualized rental income are scheduled to expire in 2015. While we have estimated our cost of renewing leases that expire in 2015, our estimates could be wrong. If we are unable to re-lease space promptly, if the terms are significantly less favorable than anticipated or if the costs are higher, we may have to reduce our distributions to shareholders.

Tenant defaults and bankruptcies may reduce our cash flow and distributions: We may have difficulty collecting from tenants in default, particularly if they declare bankruptcy. This could affect our cash flow and our ability to fund distributions to shareholders. Since many of our tenants are non-rated private companies, this risk may be enhanced. There is inherent uncertainty in a tenant s ability to continue paying rent if they are in bankruptcy.

We may be adversely affected if casualties to our properties are not covered by insurance: We could suffer uninsured losses or losses in excess of our insurance policy limits for occurrences such as earthquakes or hurricanes that adversely affect us or even result in loss of the property. Approximately 40.6% of our properties are located in California and are generally in areas that are subject to risks of earthquake-related damage. In the event of an earthquake, hurricane or other natural disaster, we might still remain liable on any mortgage debt or other unsatisfied obligations related to that property.

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

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

We may incur significant environmental remediation costs: As an owner and operator of real properties, under various federal, state and local environmental laws, we are required to clean up spills or other releases of hazardous or toxic substances on or from our properties. Certain environmental laws impose liability whether or not the owner or buyer knew of, or was responsible for, the presence of the hazardous or toxic substances. In some cases, liability may not be limited to the value of the property. The presence of these substances, or the failure to properly remediate any resulting contamination, whether from environmental or microbial issues, also may adversely affect our ability to sell, lease, operate, or encumber our facilities for purposes of borrowing.

We have conducted preliminary environmental assessments of most of our properties (and conduct these assessments in connection with property acquisitions) to evaluate the environmental condition of, and potential environmental liabilities associated with, our properties. These assessments generally consist of an investigation of environmental conditions at the property (including soil or groundwater sampling or analysis if appropriate), as well as a review of available information regarding the site and publicly available data regarding conditions at other sites in the vicinity. In connection with these property assessments, our operations and recent property acquisitions, we have become aware that prior operations or activities at some properties or from nearby locations have or may have resulted in contamination to the soil or groundwater at these properties. In circumstances where our environmental assessments disclose potential or actual contamination, we may attempt to obtain indemnifications and, in appropriate circumstances, we obtain limited environmental insurance in connection with the properties acquired, but we cannot assure you that such protections will be sufficient to cover actual future liabilities nor that our assessments have identified all such risks. Although we cannot provide any assurance, based on the preliminary environmental assessments, we are not aware of any environmental contamination of our facilities material to our overall business, financial condition or results of operations.

There has been an increasing number of claims and litigation against owners and managers of rental properties relating to moisture infiltration, which can result in mold or other property damage. When we receive a complaint concerning moisture infiltration, condensation or mold problems and/or become aware that an air quality concern exists, we implement corrective measures in accordance with guidelines and protocols we have developed with the assistance of outside experts. We seek to work proactively with our tenants to resolve moisture infiltration and mold-related issues, subject to our contractual limitations on liability for such claims. However, we can give no assurance that material legal claims relating to moisture infiltration and the presence of, or exposure to, mold will not arise in the future.

Property taxes can increase and cause a decline in yields on investments: Each of our properties is subject to real property taxes, which could increase in the future as property tax rates change and as our properties are assessed or reassessed by tax authorities. Recent local government shortfalls in tax revenue may cause pressure to increase tax rates or assessment levels or impose new taxes. Such increases could adversely impact our profitability.

We must comply with the Americans with Disabilities Act and fire and safety regulations, which can require significant expenditures: All our properties must comply with the Americans with Disabilities Act and with related regulations (the ADA). The ADA has separate compliance requirements for public accommodations and commercial facilities, but generally requires that buildings be made accessible to persons with disabilities. Various state laws impose similar requirements. A failure to comply with the ADA or similar state laws could lead to government imposed fines on us and/or litigation, which could also involve an award of damages to individuals affected by the non-compliance. In addition, we must operate our properties in compliance with numerous local fire and safety regulations, building codes, and other land use regulations. Compliance with these requirements can require us to spend substantial amounts of money, which would reduce cash otherwise available for distribution to shareholders. Failure to comply with these requirements could also affect the marketability of our real estate facilities.

We incur liability from tenant and employment-related claims: From time to time we have to make monetary settlements or defend actions or arbitration to resolve tenant or employment-related claims and disputes.

Global economic conditions adversely affect our business, financial condition, growth and access to capital.

There continues to be global economic uncertainty, elevated levels of unemployment and reduced levels of economic activity, and it is uncertain as to when economic conditions will improve. These negative economic conditions in the markets where we operate facilities, and other events or factors that adversely affect demand for commercial real estate, could continue to adversely affect our business. To the extent that turmoil in the financial markets returns or intensifies, it has the potential to materially affect the value of our properties, the availability or the terms of financing and may impact the ability of our customers to enter into new leasing transactions or satisfy rental payments under existing leases. The uncertainty and pace of an economic recovery could also affect our operating results and financial condition as follows:

Debt and Equity Markets: Our results of operations and share price are sensitive to volatility in the credit markets. From time to time, the commercial real estate debt markets experience volatility as a result of various factors, including changing underwriting standards by lenders and credit rating agencies. This may result in lenders increasing the cost for debt financing. Should the overall cost of borrowings increase, either by increases in the index rates or by increases in lender spreads, we will need to factor such increases into the economics of our acquisitions. In addition, the state of the debt markets could have an effect on the overall amount of capital being invested in real estate, which may result in price or value decreases of real estate assets and affect our ability to raise capital.

Our ability to issue preferred shares or obtain other sources of capital, such as borrowing, has been in the past, and may in the future, be adversely affected by challenging credit market conditions. The issuance of perpetual preferred securities historically has been a significant source of capital to grow our business. We believe that we have sufficient working capital and capacity under our credit facilities and our retained cash flow from operations to continue to operate our business as usual and meet our current obligations. However, if we were unable to issue preferred shares or borrow at reasonable rates, that could limit the earnings growth that might otherwise result from the acquisition and development of real estate facilities.

Valuations: Market volatility makes the valuation of our properties difficult. There may be significant uncertainty in the valuation, or in the stability of the value, of our properties, which could result in a substantial decrease in the value of our properties. As a result, we may not be able to recover the carrying amount of our properties, which may require us to recognize an impairment charge in earnings.

The acquisition of existing properties is a significant component of our long-term growth strategy, and acquisitions of existing properties are subject to risks that may adversely affect our growth and financial results.

We acquire existing properties, either in individual transactions or portfolios offered by other commercial real estate owners. In addition to the general risks related to real estate described above, we are also subject to the following risks which may jeopardize our realization of benefits from acquisitions.

Any failure to manage acquisitions and other significant transactions to achieve anticipated results and to successfully integrate acquired operations into our existing business could negatively impact our financial results: To fully realize anticipated earnings from an acquisition, we must successfully integrate the property into our operating platform. Failures or unexpected circumstances in the integration process, such as a failure to maintain existing relationships with tenants and employees due to changes in processes, standards, or compensation arrangements, or circumstances we did not detect during due diligence, could jeopardize realization of the anticipated earnings.

During 2014, we acquired 678,000 square feet for an aggregate purchase price of $45.6 million and average occupancy of 69.5% at the time of acquisitions, and we will continue to seek to acquire additional multi-tenant flex, industrial and office properties where they meet our criteria. Our acquisitions and developments may not perform as expected, we may be unable to quickly integrate new acquisitions and developments into our existing operations, and any costs to develop projects or redevelop acquired properties may exceed estimates. As of December 31, 2014, the aggregate occupancy of the assets acquired in 2014 was 69.5%. If we are unable to lease the vacant square footage of these properties in a reasonable period of time, we may not be able to achieve our objective of enhancing value. Further, we face significant competition for suitable acquisition properties from other real estate investors, including other publicly traded real estate investment trusts and private institutional investors. As a result, we may be unable to acquire additional properties we desire or the purchase price for desirable properties may be significantly increased.

In addition, some of these properties may have unknown characteristics or deficiencies or may not complement our portfolio of existing properties. We may also finance future acquisitions and developments through a combination of borrowings, proceeds from equity or debt offerings by us or the Operating Partnership, and proceeds from property divestitures. These financing options may not be available when desired or required or may be more costly than anticipated, which could adversely affect our cash flow. Real property development is subject to a number of risks, including construction delays, complications in obtaining necessary zoning, occupancy and other governmental permits, cost overruns, financing risks, and the possible inability to meet expected occupancy and rent levels. If any of these problems occur, development costs for a project may increase, and there may be costs incurred for projects that are not completed. As a result of the foregoing, some properties may be worth less or may generate less revenue than, or simply not perform as well as, we believed at the time of acquisition or development, negatively affecting our operating results. Any of the foregoing risks could adversely affect our financial condition, operating results and cash flow, and our ability to pay dividends on, and the market price of, our stock. In addition, we may be unable to successfully integrate and effectively manage the properties we do acquire and develop, which could adversely affect our results of operations.

Acquired properties are subject to property tax reappraisals which may increase our property tax expense: Facilities that we acquire are subject to property tax reappraisal which can result in substantial increases to the ongoing property taxes paid by the seller. The reappraisal process is subject to judgment of governmental agencies regarding estimated real estate values and other factors, and as a result there is a significant degree of uncertainty in estimating the property tax expense of an acquired property. In connection with future or recent acquisitions of properties, if our estimates of property taxes following reappraisal are too low, we may not realize anticipated earnings from an acquisition.

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

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

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

During 2014, the Company sold a combined total of 1.9 million square feet along with some parcels of land in Beaverton, Oregon and Phoenix, Arizona. Absent a special distribution in excess of our normal, recurring quarterly dividend, the Company would have had taxable income in excess of distributions resulting in federal income tax at the corporate level. To qualify for the dividends paid deduction for tax purposes and minimize this potential tax, on December 30, 2014, the Company paid a one-time special cash dividend of $2.75 per common share along with the fourth quarter 2014 regular dividend of $0.50 per common share. Holders of common partnership units of the Operating Partnership also received the same distribution on December 30, 2014. The Board of Directors will continue to evaluate our dividend rate in light of our actual and projected taxable income, liquidity requirements and other circumstances, and there can be no assurance that the future dividends declared by our Board of Directors will not differ materially.

PS has significant influence over us.

Assuming issuance of the Company s common stock upon redemption of its partnership units, PS would own 42.3% (or 14.5 million shares) of the outstanding shares of the Company s common stock at December 31, 2014. As of December 31, 2014, PS owned 7.2 million shares of the Company s common stock and 7.3 million common units of the Operating Partnership (100.0% of the common units not owned by the Company). In addition, the PS Business Parks name and logo are owned by PS and licensed to the Company under a non-exclusive, royalty-free license agreement. The license can be terminated by either party for any reason with six months written notice. Ronald L. Havner, Jr., the Company s chairman, is also Chairman of the Board, Chief Executive Officer and President of PS. Gary E. Pruitt, an independent director of the Company is also a trustee of PS. Consequently, PS has the ability to significantly influence all matters submitted to a vote of our shareholders, including electing directors, changing our articles of incorporation, dissolving and approving other extraordinary transactions such as mergers, and all matters requiring the consent of the limited partners of the Operating Partnership. PS s interest in such matters may differ from other shareholders. In addition, PS s ownership may make it more difficult for another party to take over our Company without PS s approval.

Provisions in our organizational documents may prevent changes in control.

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

Our board can set the terms of certain securities without shareholder approval: Our board of directors is authorized, without shareholder approval, to issue up to 50.0 million shares of preferred stock and up to 100.0 million shares of equity stock, in each case in one or more series. Our board has the right to set the terms of each of these series of stock. Consequently, the board could set the terms of a series of stock that could make it difficult (if not impossible) for another party to take over our Company even if it might be favorable to our public shareholders. Our articles of incorporation also contain other provisions that could have the same effect. We can also cause our Operating Partnership to issue additional interests for cash or in exchange for property.

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

The interests of limited partners of our Operating Partnership may conflict with the interests of our common stockholders.

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

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

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

We are subject to laws and governmental regulations and actions that affect our operating results and financial condition.

Our business is subject to regulation under a wide variety of U.S. federal, state and local laws, regulations and policies including those imposed by the SEC, the Sarbanes-Oxley Act of 2002, the Dodd-Frank Wall Street Reform and Consumer Protection Act and the New York Stock Exchange, as well as applicable labor laws. Although we have policies and procedures designed to comply with applicable laws and regulations, failure to comply with the various laws and regulations may result in civil and criminal liability, fines and penalties, increased costs of compliance and restatement of our financial statements.

There can also be no assurance that, in response to current economic conditions or the current political environment or otherwise, laws and regulations will not be implemented or changed in ways that adversely affect our operating results and financial condition, such as recently adopted legislation that expands health care coverage costs or facilitates union activity or federal legislative proposals to otherwise increase operating costs.

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

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

Developments in California may have an adverse impact on our business and financial results.

We are headquartered in, and approximately 40.6% of our properties are located in California, which has from time to time faced budgetary problems and deficits. Actions have been and may continue to be taken in response to these problems, such as increases in property taxes, changes to sales taxes or other governmental efforts to raise revenues, which could adversely impact our business and results of operations.

Holders of depositary shares, each representing 1/1,000 of a share of our outstanding preferred stock, have dividend, liquidation and other rights that are senior to the rights of the holders of shares of our common stock.

Our shares of preferred stock are entitled to cumulative dividends before any dividends may be declared or set aside on our common stock. Upon our voluntary or involuntary liquidation, dissolution or winding up, before any payment is made to holders of our common stock, shares of our preferred stock are entitled to receive a liquidation preference of $25,000 per share (or $25.00 per depositary share) plus any accrued and unpaid distributions. This will reduce the remaining amount of our assets, if any, available to distribute to holders of our common stock. In addition, our preferred stockholders have the right to elect two additional directors to our board of directors whenever dividends are in arrears in an aggregate amount equivalent to six or more quarterly dividends, whether or not consecutive.

Future issuances by us of shares of our common stock may be dilutive to existing stockholders, and future sales of shares of our common stock may adversely affect the market price of our common stock.

Sales of substantial amounts of shares of our common stock in the public market (either by us or by PS), or issuances of shares of common stock in connection with redemptions of common units of our Operating Partnership, could adversely affect the market price of our common stock. During the year ended December 31, 2013, the Company completed a public offering of its common stock and may seek to engage in such offerings in the future. Offerings of common stock, including by us in connection with portfolio or other property acquisitions or by PS in secondary offerings, and the issuance of common units of the Operating Partnership in exchange for shares of common stock, could have an adverse effect on the market price of the shares of our common stock.

We rely on technology in our operations and failures, inadequacies or interruptions to our service could harm our business.

The execution of our business strategy is heavily dependent on the use of technologies and systems, including the Internet, to access, store, transmit, deliver and manage information and processes. Although we believe we have taken commercially reasonable steps to protect the security of our systems, there can be no assurance that such security measures will prevent failures, inadequacies or interruptions in system services, or that system security will not be breached. Disruptions in service, system shutdowns and security breaches could have a material adverse effect on our business.

ITEM 1B. ***UNRESOLVED STAFF COMMENTS***

None.

ITEM 2. ***PROPERTIES***

As of December 31, 2014, the Company owned 103 business parks consisting of a geographically diverse portfolio of 28.6 million rentable square feet of commercial real estate which consists of 15.1 million square feet of flex space, 8.8 million square feet of industrial space and 4.6 million square feet of office space concentrated primarily in six states consisting of California, Texas, Virginia, Florida, Maryland and Washington. The weighted average occupancy rate throughout 2014 was 91.3% and the realized rent per square foot was $14.00.

The following table reflects the geographical diversification of the 103 business parks owned by the Company as of December 31, 2014, the type of the rentable square footage and the weighted average occupancy rates throughout 2014 (except as set forth below, all of the properties are held in fee simple interest) *(in thousands, except number of business parks)*:

State	Number of Business Parks	Rentable Square Footage				Weighted Average Occupancy Rate
		Flex	Industrial	Office	Total	
California (1)	49	5,906	4,618	1,076	11,600	93.4%
Texas (2)	23	4,611	477		5,088	87.7%
Virginia	17	1,947		2,093	4,040	90.3%
Florida	3	1,074	2,780	12	3,866	94.6%
Maryland	6	970		1,382	2,352	87.8%
Washington	3	493	958	28	1,479	86.3%
Total	101	15,001	8,833	4,591	28,425	91.3%
Assets held for sale	2	125			125	97.3%
Total	103	15,126	8,833	4,591	28,550	91.3%

(1) The Company has 4.8 million square feet in California that serves as collateral to a mortgage note payable. For more information, see Note 6 to the consolidated financial statements included in this Form 10-K.

(2) The Company owns two properties comprising of 232,000 square feet that are subject to ground leases in Las Colinas, Texas, expiring in 2019 and 2020, each with one 10 year extension option.

We currently anticipate that each of the properties listed above will continue to be used for its current purpose. Competition exists in each of the market areas in which these properties are located.

The Company renovates its properties in connection with the re-leasing of space to tenants and expects that it will pay the costs of such renovations from rental income. From time to time the Company may identify higher and better use of its assets. The Company has risks that tenants will default on leases and declare bankruptcy. Management believes these risks are mitigated through the Company s geographic diversity and diverse tenant base.

The Company evaluates the performance of its business parks primarily based on net operating income (NOI). NOI is defined by the Company as rental income as defined by GAAP less cost of operations as defined by GAAP, excluding depreciation and amortization. The Company uses NOI and its components as a measurement of the performance of its commercial real estate. Management believes that these financial measures provide them, as well as the investor, the most consistent measurement on a comparative basis of the performance of the commercial real estate and its contribution to the value of the Company. Depreciation and amortization have been excluded from NOI as they are generally not used in determining the value of commercial real estate by management or the investment community. Depreciation and amortization are generally not used in determining value as they consider the historical costs of an asset compared to its current value; therefore, to understand the effect of the assets historical cost on the Company s results, investors should look at GAAP financial measures, such as total operating costs including depreciation and amortization. The Company s calculation of NOI may not be comparable to those of other companies and should not be used as an alternative to measures of performance calculated in accordance with GAAP. Following the table below, we have reconciled total NOI to income from continuing operations, which we consider the most directly comparable financial measure calculated in accordance with GAAP.

The following information illustrates rental income, cost of operations and NOI generated by the Company s total portfolio in 2014, 2013 and 2012 by state and by property classifications. As a result of acquisitions and dispositions, certain properties were not held for the full year and are reflected as assets held for sale or sold.

The Company s calculation of NOI may not be comparable to those of other companies and should not be used as an alternative to measures of performance in accordance with GAAP. In order to provide a meaningful period-to-period comparison, the tables below exclude certain lease buyout payments noted below and amortization of the Senior Management Long-Term Equity Incentive Plan (LTEIP) related to field leadership. The tables below also include a reconciliation of NOI to the most comparable amounts based on GAAP *(in thousands)*:

	For the Year Ended December 31, 2014				For the Year Ended December 31, 2013				For the Year Ended December 31, 2012			
	Flex	**Office**	**Industrial**	**Total**	**Flex**	**Office**	**Industrial**	**Total**	**Flex**	**Office**	**Industrial**	**Total**
Rental Income:												
California	$ 73,922	$ 19,890	$ 37,291	$ 131,103	$ 70,642	$ 13,184	$ 34,896	$ 118,722	$ 68,397	$ 12,773	$ 33,210	$ 114,380
Texas	45,881		1,564	47,445	37,783		1,391	39,174	32,878		1,297	34,175
Virginia	32,108	49,204		81,312	33,373	48,942		82,315	34,341	48,096		82,437
Florida	12,180	285	21,538	34,003	11,414	210	20,672	32,296	10,686	206	20,649	31,541
Maryland	15,667	33,585		49,252	15,299	32,954		48,253	15,470	33,495		48,965
Washington	8,128	568	5,052	13,748	7,808	493	3,433	11,734	7,628	521	1,338	9,487
Assets held for sale or sold	16,654	2,738		19,392	20,908	3,592		24,500	20,381	3,399		23,780
Total	204,540	106,270	65,445	376,255	197,227	99,375	60,392	356,994	189,781	98,490	56,494	344,765
Cost of Operations:												
California	23,540	9,094	9,118	41,752	23,304	5,763	9,115	38,182	22,243	5,400	9,479	37,122
Texas	16,977		431	17,408	13,034		287	13,321	11,103		406	11,509
Virginia	9,483	16,164		25,647	9,191	15,947		25,138	8,651	17,208		25,859
Florida	3,895	120	6,491	10,506	3,810	141	6,070	10,021	3,868	171	5,991	10,030
Maryland	5,709	11,765		17,474	4,916	10,899		15,815	4,689	10,938		15,627
Washington	2,349	202	1,652	4,203	2,380	189	1,606	4,175	2,355	193	667	3,215
Assets held for sale or sold	6,618	1,140		7,758	7,926							