PS BUSINESS PARKS INC/CA
Form 10-Q
October 30, 2015
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2015

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	(I.R.S. Employer

of Incorporation) Identification Number)

701 Western Avenue, Glendale, California 91201-2397

(Address of principal executive offices) (Zip Code)

Registrant’s telephone number, including area code: (818) 244-8080

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

Yes No

Indicate by check mark whether the registrant 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 definition of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer 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

As of October 26, 2015, the number of shares of the registrant’s common stock, $0.01 par value per share, outstanding was 27,013,685.

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PS BUSINESS PARKS, INC.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

PS BUSINESS PARKS, INC.

CONSOLIDATED BALANCE SHEETS

(In thousands, except share data)

	September 30, 2015 (Unaudited)	December 31, 2014
ASSETS		
Cash and cash equivalents	$ 252,142	$ 152,467
Real estate facilities, at cost:		
Land	793,569	793,569
Buildings and improvements	2,209,219	2,182,993
	3,002,788	2,976,562
Accumulated depreciation	(1,059,561)	(991,497)
	1,943,227	1,985,065
Properties held for disposition, net	—	25,937
Land and building held for development	27,251	24,442
	1,970,478	2,035,444
Rent receivable, net	3,788	2,838
Deferred rent receivable, net	28,147	26,050
Other assets	9,982	10,315
Total assets	$ 2,264,537	$ 2,227,114
LIABILITIES AND EQUITY		
Accrued and other liabilities	$ 80,662	$ 68,905
Preferred stock called for redemption	75,000	—
Mortgage note payable	250,000	250,000
Total liabilities	405,662	318,905

Commitments and contingencies		
Equity:		
PS Business Parks, Inc.'s shareholders' equity:		
Preferred stock, $0.01 par value, 50,000,000 shares authorized, 36,800 and 39,800 shares issued and outstanding at September 30, 2015 and December 31, 2014, respectively	920,000	995,000
Common stock, $0.01 par value, 100,000,000 shares authorized, 27,013,685 and 26,919,161 shares issued and outstanding at September 30, 2015 and December 31, 2014, respectively	268	268
Paid-in capital	719,282	709,008
Cumulative net income	1,346,420	1,244,946
Cumulative distributions	(1,326,950)	(1,235,941)
Total PS Business Parks, Inc.'s shareholders' equity	1,659,020	1,713,281
Noncontrolling interests:		
Common units	199,855	194,928
Total noncontrolling interests	199,855	194,928
Total equity	1,858,875	1,908,209
Total liabilities and equity	$ 2,264,537	$ 2,227,114

See accompanying notes.

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PS BUSINESS PARKS, INC.

CONSOLIDATED STATEMENTS OF INCOME

(Unaudited, in thousands, except per share data)

	For The Three Months Ended September 30,		For The Nine Months Ended September 30,	
	2015	2014	2015	2014
Revenues:				
Rental income	$ 93,322	$ 95,627	$ 278,585	$ 284,934
Facility management fees	130	164	410	495
Total operating revenues	93,452	95,791	278,995	285,429
Expenses:				
Cost of operations	30,448	33,102	92,251	98,081
Depreciation and amortization	25,985	26,811	79,243	83,547
General and administrative	3,276	3,078	10,172	8,928
Total operating expenses	59,709	62,991	181,666	190,556
Other income and (expense):				
Interest and other income	154	90	406	247
Interest and other expense	(3,368)	(3,412)	(10,029)	(10,191)
Total other income and (expense)	(3,214)	(3,322)	(9,623)	(9,944)
Gain on sale of real estate facilities	15,748	—	28,235	—
Net income	$ 46,277	$ 29,478	$ 115,941	$ 84,929
Net income allocation:				
Net income allocable to noncontrolling interests:				
Noncontrolling interests—common units	$ 6,087	$ 3,058	$ 14,467	$ 8,430
Total net income allocable to noncontrolling interests	6,087	3,058	14,467	8,430
Net income allocable to PS Business Parks, Inc.:				
Preferred shareholders	17,609	15,122	47,853	45,366
Restricted stock unit holders	97	30	237	99
Common shareholders	22,484	11,268	53,384	31,034
Total net income allocable to PS Business Parks, Inc.	40,190	26,420	101,474	76,499
Net income	$ 46,277	$ 29,478	$ 115,941	$ 84,929
Net income per common share:				
Basic	$ 0.83	$ 0.42	$ 1.98	$ 1.15
Diluted	$ 0.83	$ 0.42	$ 1.97	$ 1.15

Weighted average common shares outstanding:				
Basic	26,985	26,914	26,956	26,892
Diluted	27,049	27,003	27,034	26,988
Dividends declared per common share	$ 0.60	$ 0.50	$ 1.60	$ 1.50

See accompanying notes.

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PS BUSINESS PARKS, INC.

CONSOLIDATED STATEMENT OF EQUITY

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2015

(Unaudited, in thousands, except share data)

	Preferred Stock		Common Stock		Paid-in	Cumulative	Cumulative	Total PS Business Parks, Inc.'s Shareholders'	Noncontro
	Shares	Amount	Shares	Amount	Capital	Net Income	Distributions	Equity	Interests
Balances at December 31, 2014	39,800	$ 995,000	26,919,161	$ 268	$ 709,008	$ 1,244,946	$ (1,235,941)	$ 1,713,281	$ 194,928
Redemption of preferred stock, net of costs	(3,000)	(75,000)	—	—	2,487	—	(2,487)	(75,000)	—
Exercise of stock options	—	—	78,790	—	3,987	—	—	3,987	—
Stock compensation, net	—	—	15,734	—	5,949	—	—	5,949	—
Net income	—	—	—	—	—	101,474	—	101,474	14,467
Distributions:									
Preferred stock	—	—	—	—	—	—	(45,366)	(45,366)	—
Common stock	—	—	—	—	—	—	(43,156)	(43,156)	—
Noncontrolling interests	—	—	—	—	—	—	—	—	(11,689
Adjustment to noncontrolling interests in underlying operating partnership	—	—	—	—	(2,149)	—	—	(2,149)	2,149
Balances at September 30, 2015	36,800	$ 920,000	27,013,685	$ 268	$ 719,282	$ 1,346,420	$ (1,326,950)	$ 1,659,020	$ 199,855

See accompanying notes.

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PS BUSINESS PARKS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited, in thousands)

	For The Nine Months Ended September 30, 2015		2014	
Cash flows from operating activities:				
Net income	$	115,941	$	84,929
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization expense		79,243		83,547
In-place lease adjustment		(1,004)		(672)
Tenant improvement reimbursements net of lease incentives		(1,418)		(1,194)
Gain on sale of real estate facilities		(28,236)		—
Stock compensation		6,949		6,116
Increase in receivables and other assets		(4,258)		(1,200)
Increase in accrued and other liabilities		11,398		7,432
Total adjustments		62,674		94,029
Net cash provided by operating activities		178,615		178,958
Cash flows from investing activities:				
Capital expenditures to real estate facilities		(35,067)		(38,666)
Capital expenditures to land and building held for development		(2,809)		(1,775)
		—		(18,842)

Acquisition of real estate facilities				
Proceeds from sale of real estate facilities		55,160		—
Net cash provided by (used in) investing activities		17,284		(59,283)
Cash flows from financing activities:				
Proceeds from the exercise of stock options		3,987		3,054
Distributions paid to preferred shareholders		(45,366)		(45,366)
Distributions paid to noncontrolling interests—common units		(11,689)		(10,958)
Distributions paid to common shareholders		(43,156)		(40,351)
Net cash used in financing activities		(96,224)		(93,621)
Net increase in cash and cash equivalents		99,675		26,054
Cash and cash equivalents at the beginning of the period		152,467		31,481
Cash and cash equivalents at the end of the period	$	252,142	$	57,535
Supplemental schedule of non-cash investing and financing activities:				
Adjustment to noncontrolling interests in underlying operating partnership:				
Noncontrolling interests—common units	$	2,149	$	1,472
Paid-in capital	$	(2,149)	$	(1,472)
Non-cash distributions related to the redemption of preferred stock:				
Paid-in capital	$	2,487	$	—
Cumulative distributions	$	(2,487)	$	—
Preferred stock called for redemption:				
Preferred stock called for redemption and reclassified to liabilities	$	75,000	$	—
Preferred stock called for redemption and reclassified from equity	$	(75,000)	$	—

See accompanying notes.

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PS BUSINESS PARKS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2015

1. Organization and description of business

PS Business Parks, Inc. ("PSB") was incorporated in the state of California in 1990. As of September 30, 2015, PSB owned 77.8% of the common partnership units of PS Business Parks, L.P. (the "Operating Partnership"). The remaining common partnership units are owned by Public Storage ("PS"). PSB, as the sole general partner of the Operating Partnership, has full, exclusive and complete responsibility and discretion in managing and controlling the Operating Partnership. PSB and its subsidiaries, including the Operating Partnership are collectively referred to as the "Company." Assuming issuance of the Company's common stock upon redemption of its partnership units, PS would own 42.1% (or 14.5 million shares) of the outstanding shares of the Company's common stock.

The Company is a fully-integrated, self-advised and self-managed real estate investment trust ("REIT") that owns, operates, acquires and develops commercial properties, primarily multi-tenant flex, office and industrial space. As of September 30, 2015, the Company owned and operated 28.0 million rentable square feet of commercial space concentrated primarily in six states. The Company also manages 838,000 rentable square feet on behalf of PS.

References to the number of properties or square footage are unaudited and outside the scope of the Company's independent registered public accounting firm's review of the Company's financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States).

2. Summary of significant accounting policies

Basis of presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial information and with instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) necessary for a fair presentation have been included. Operating results for the three and nine months ended September 30, 2015 are not necessarily indicative of the results that may be expected for the year ended December 31, 2015. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2014.

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

Noncontrolling interests

The Company's noncontrolling interests are reported as a component of equity separate from the parent's equity. Purchases or sales of equity interests that do not result in a change in control are accounted for as equity transactions. In addition, net income attributable to the noncontrolling interests is included in consolidated net income on the face of the income statement and, upon a gain or loss of control, the interests purchased or sold, as well as any interests retained, are recorded at fair value with any gain or loss recognized in earnings. At the end of each reporting period, the Company determines the amount of equity (book value of net assets) which is allocable to the noncontrolling interests based upon the ownership interest, and an adjustment is made to the noncontrolling interests, with a corresponding adjustment to paid-in capital, to reflect the noncontrolling interests' equity interest in the Company.

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Use of estimates

The preparation of the consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from these estimates.

Allowance for doubtful accounts

The Company monitors the collectability of its receivable balances including the deferred rent receivable on an ongoing basis. Based on these reviews, the Company maintains an allowance for doubtful accounts for estimated losses resulting from the possible inability of tenants to make contractual rent payments to the Company. A provision for doubtful accounts is recorded during each period. The allowance for doubtful accounts, which represents the cumulative allowances less write-offs of uncollectible rent, is netted against tenant and other receivables on the consolidated balance sheets. Tenant receivables are net of an allowance for uncollectible accounts totaling $400,000 at September 30, 2015 and December 31, 2014. Deferred rent receivable is net of an allowance for uncollectible accounts totaling $889,000 and $841,000 at September 30, 2015 and December 31, 2014, respectively.

Financial instruments

The methods and assumptions used to estimate the fair value of financial instruments are described below. The Company has estimated the fair value of financial instruments using available market information and appropriate valuation methodologies. Considerable judgment is required in interpreting market data to develop estimates of market value. Accordingly, estimated fair values are not necessarily indicative of the amounts that could be realized in current market exchanges. The Company determines the estimated fair value of financial assets and liabilities utilizing a hierarchy of valuation techniques based on whether the inputs to a fair value measurement are considered to be observable or unobservable in a marketplace. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect market assumptions. This hierarchy requires the use of observable market data when available. The following is the fair value hierarchy:

- Level 1—quoted prices for identical instruments in active markets;
- Level 2—quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which significant inputs and significant value drivers are observable in active markets; and
- Level 3—fair value measurements derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

Financial assets that are exposed to credit risk consist primarily of cash and cash equivalents and receivables. The Company considers all highly liquid investments with a remaining maturity of three months or less at the date of purchase to be cash equivalents. Cash and cash equivalents, which consist primarily of money market investments, are only invested in entities with an investment grade rating. Receivables are comprised of balances due from a large number of customers. Balances that the Company expects to become uncollectible are reserved for or written off. Due to the short period to maturity of the Company's cash and cash equivalents, accounts receivable, other assets and accrued and other liabilities, the carrying values as presented on the consolidated balance sheets are reasonable estimates of fair value.

Carrying values of the Company's mortgage note payable and unsecured credit facility approximate fair value. The characteristics of these financial instruments, market data and other comparative metrics utilized in determining these fair values are "Level 2" inputs.

Real estate facilities

Real estate facilities are recorded at cost. Costs related to the renovation or improvement of the properties are capitalized. Expenditures for repairs and maintenance are expensed as incurred. Expenditures that are expected to

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benefit a period greater than two years and exceed $2,000 are capitalized and depreciated over their estimated useful life. Buildings and improvements are depreciated using the straight-line method over their estimated useful lives, which generally range from five to 30 years. Transaction costs, which include tenant improvements and lease commissions, in excess of $1,000 for leases with terms greater than one year are capitalized and depreciated over their estimated useful lives. Transaction costs less than $1,000 or for leases of one year or less are expensed as incurred.

Land and building held for development

Property taxes, insurance, interest and costs essential to the development of property for its intended use are capitalized during the period of development. Upon classification of an asset as held for development, depreciation of the asset is ceased.

Properties held for disposition

An asset is classified as an asset held for disposition when it meets certain requirements, which include, among other criteria, the approval of the sale of the asset, the marketing of the asset for sale and the expectation by the Company that the sale will likely occur within the next 12 months. Upon classification of an asset as held for disposition, depreciation of the asset is ceased, and the net book value of the asset is included on the balance sheet as properties held for disposition.

Intangible assets/liabilities

Intangible assets and liabilities include above-market and below-market in-place lease values of acquired properties based on the present value (using an interest rate which reflects the risks associated with the leases acquired) of the difference between (i) the contractual amounts to be paid pursuant to the in-place leases and (ii) management’s estimate of fair market lease rates for the corresponding in-place leases, measured over a period equal to the remaining non-cancelable term of the lease. The capitalized above-market and below-market lease values (included in other assets and accrued liabilities in the accompanying consolidated balance sheets) are amortized to rental income over the remaining non-cancelable terms of the respective leases.

As of September 30, 2015, the value of in-place leases resulted in net intangible assets of $1.8 million, net of $8.5 million of accumulated amortization with a weighted average amortization period of 8.5 years, and net intangible liabilities of $2.2 million, net of $8.6 million of accumulated amortization with a weighted average amortization period of 5.1 years. As of December 31, 2014, the value of in-place leases resulted in net intangible assets of $2.5 million, net of $7.8 million of accumulated amortization and net intangible liabilities of $3.9 million, net of $6.9 million of accumulated amortization.

The Company recorded net increases in rental income of $341,000 and $231,000 for the three months ended September 30, 2015 and 2014, respectively, and $1.0 million and $672,000 for the nine months ended September 30, 2015 and 2014, respectively, due to the amortization of net intangible liabilities resulting from the above-market and below-market lease values.

Evaluation of asset impairment

The Company evaluates its assets used in operations for impairment by identifying indicators of impairment and by comparing the sum of the estimated undiscounted future cash flows for each asset to the asset's carrying value. When indicators of impairment are present and the sum of the estimated undiscounted future cash flows is less than the carrying value of such asset, an impairment loss is recorded equal to the difference between the asset's current carrying value and its value based on discounting its estimated future cash flows. In addition, the Company evaluates its assets held for disposition for impairment. Assets held for disposition are reported at the lower of their carrying value or fair value, less cost of disposition. At September 30, 2015, the Company did not consider any assets to be impaired.

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Stock compensation

All share-based payments to employees, including grants of employee stock options, are recognized as stock compensation in the Company's income statement based on their grant date fair values. See Note 11.

Revenue and expense recognition

The Company must meet four basic criteria before revenue can be recognized: persuasive evidence of an arrangement exists; the delivery has occurred or services have been rendered; the fee is fixed or determinable; and collectability is reasonably assured. All leases are classified as operating leases. Rental income is recognized on a straight-line basis over the terms of the leases. Straight-line rent is recognized for all tenants with contractual fixed increases in rent that are not included on the Company's credit watch list. Deferred rent receivable represents rental revenue recognized on a straight-line basis in excess of billed rents. Reimbursements from tenants for real estate taxes and other recoverable operating expenses are recognized as rental income in the period the applicable costs are incurred. Property management fees are recognized in the period earned.

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

Gains from sales of real estate facilities

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

General and administrative expenses

General and administrative expenses include executive and other compensation, office expenses, professional fees, acquisition transaction costs, state income taxes and other such administrative items.

Income taxes

The Company has qualified and intends to continue to qualify as a REIT, as defined in Section 856 of the Internal Revenue Code of 1986, as amended. As a REIT, the Company is not subject to federal income tax to the extent that it distributes its REIT taxable income to its shareholders. A REIT must distribute at least 90% of its taxable income each year. In addition, REITs are subject to a number of organizational and operating requirements. The Company may be subject to certain state and local taxes on its income and property and to federal income and excise taxes on its undistributed taxable income. The Company believes it met all organization and operating requirements to maintain its REIT status during 2014 and intends to continue to meet such requirements for 2015. Accordingly, no provision for income taxes has been made in the accompanying consolidated financial statements.

The Company can recognize a tax benefit only if it is “more likely than not” that a particular tax position will be sustained upon examination or audit. To the extent that the “more likely than not” standard has been satisfied, the benefit associated with a position is measured as the largest amount that is greater than 50% likely of being recognized upon settlement. As of September 30, 2015, the Company did not recognize any tax benefit for uncertain tax positions.

Accounting for preferred equity issuance costs

The Company records issuance costs as a reduction to paid-in capital on its balance sheet at the time the preferred securities are issued and reflects the carrying value of the preferred equity at the stated value. Such issuance costs are recorded as non-cash preferred equity distributions at the time the Company notifies the holders of preferred stock of its intent to redeem such shares.

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Net income allocation

Net income was allocated as follows (in thousands):

	For The Three Months Ended September 30,		For The Nine Months Ended September 30,	
	2015	2014	2015	2014
Net income allocable to noncontrolling interests:				
Noncontrolling interests—common units	$ 6,087	$ 3,058	$ 14,467	$ 8,430
Total net income allocable to noncontrolling interests	6,087	3,058	14,467	8,430
Net income allocable to PS Business Parks, Inc.:				
Preferred shareholders				
Distributions to preferred shareholders	15,122	15,122	45,366	45,366
Non-cash distributions related to the redemption of preferred stock	2,487	—	2,487	—
Total net income allocable to preferred shareholders	17,609	15,122	47,853	45,366
Restricted stock unit holders	97	30	237	99
Common shareholders	22,484	11,268	53,384	31,034
Total net income allocable to PS Business Parks, Inc.	40,190	26,420	101,474	76,499
Net income	$ 46,277	$ 29,478	$ 115,941	$ 84,929

Net income per common share

Per share amounts are computed using the number of weighted average common shares outstanding. “Diluted” weighted average common shares outstanding includes the dilutive effect of stock options and restricted stock units under the treasury stock method. “Basic” weighted average common shares outstanding excludes such effect. The Company's restricted stock units are participating securities and are included in the computation of basic and diluted weighted average common shares outstanding. The Company’s restricted stock unit holders are paid non-forfeitable dividends in excess of the expense recorded which results in a reduction in net income allocable to common shareholders and unit holders. Earnings per share has been calculated as follows (in thousands, except per share amounts):

	For The Three Months Ended September 30,		For The Nine Months Ended September 30,	
	2015	2014	2015	2014
Net income allocable to common shareholders	$ 22,484	$ 11,268	$ 53,384	$ 31,034
Weighted average common shares outstanding:				
Basic weighted average common shares outstanding	26,985	26,914	26,956	26,892
Net effect of dilutive stock compensation—based on treasury stock method using average market price	64	89	78	96
Diluted weighted average common shares outstanding	27,049	27,003	27,034	26,988
Net income per common share—Basic	$ 0.83	$ 0.42	$ 1.98	$ 1.15
Net income per common share—Diluted	$ 0.83	$ 0.42	$ 1.97	$ 1.15

Options to purchase 46,000 for the three and nine months ended September 30, 2015 were not included in the computation of diluted net income per share because such options were considered anti-dilutive. Options to purchase 30,000 and 16,000 shares for the three and nine months ended September 30, 2014, respectively, were not included in the computation of diluted net income per share because such options were considered anti-dilutive.

Segment reporting

The Company views its operations as one segment.

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Reclassifications

Certain reclassifications have been made to the consolidated financial statements for 2014 in order to conform to the 2015 presentation.

Recently issued accounting standards

In May, 2014, the FASB issued new accounting guidance which amended the existing accounting standards for revenue recognition. The new accounting guidance establishes principles for recognizing revenue upon the transfer of promised goods or services to customers, in an amount that reflects the expected consideration received in exchange for those goods or services. This guidance is currently effective for the Company’s fiscal year beginning January 1, 2018. Early adoption is permitted for the Company’s fiscal year beginning January 1, 2017. The amendments may be applied retrospectively to each prior period presented or retrospectively with the cumulative effect recognized as of the date of initial application. The Company is currently in the process of evaluating the impact of adoption of the new accounting guidance on its consolidated financial statements.

3. Real estate facilities

The activity in real estate facilities for the nine months ended September 30, 2015 is as follows (in thousands):

	Land	Buildings and Improvements	Accumulated Depreciation	Total
Balances at December 31, 2014	$ 793,569	$ 2,182,993	$ (991,497)	$ 1,985,065
Capital expenditures, net	—	37,372	—	37,372
Disposals	—	(10,701)	10,701	—
Depreciation and amortization	—	—	(79,243)	(79,243)
Transfer to properties held for disposition	—	(445)	478	33
Balances at September 30, 2015	$ 793,569	$ 2,209,219	$ (1,059,561)	$ 1,943,227

The purchase price of acquired properties is recorded to land, buildings and improvements (including tenant improvements, unamortized lease commissions, acquired in-place lease values, and tenant relationships, if any) and intangible assets and liabilities associated with the value of above-market and below-market leases based on their respective estimated fair values. Acquisition-related costs are expensed as incurred.

In determining the fair value of the tangible assets of the acquired properties, management considers the value of the properties as if vacant as of the acquisition date. Management must make significant assumptions in determining the value of assets acquired and liabilities assumed. Using different assumptions in the recording of the purchase cost of the acquired properties would affect the timing of recognition of the related revenue and expenses. Amounts recorded to land are derived from comparable sales of land within the same region. Amounts recorded to buildings and improvements, tenant improvements and unamortized lease commissions are based on current market replacement costs and other market information. The amount recorded to acquired in-place leases is determined based on management's assessment of current market conditions and the estimated lease-up periods for the respective spaces.

On September 28, 2015, the Company completed the sale of McKellips Business Park located in Tempe, Arizona, aggregating 23,000 square feet, for net proceeds of $1.3 million, which resulted in a net gain of $759,000.

In July, 2015, the Company completed the sale of two business parks located in Sacramento, California, for net proceeds of $29.3 million, which resulted in a net gain of $15.0 million. On July 24, 2015, the Company disposed of North Pointe Business Park, which consists of five multi-tenant flex buildings aggregating 213,000 square feet. On July 31, 2015, the Company disposed of Northgate Business Park, which consists of 12 multi-tenant flex buildings comprising 154,000 square feet.

On February 27, 2015, as part of an eminent domain process with the Central Puget Sound Regional Transit Authority, the Company sold five buildings, aggregating 82,000 square feet, at the Company's Overlake Business Park located in Redmond, Washington, for $13.9 million, which resulted in a net gain of $4.8 million.

On February 13, 2015, the Company completed the sale of Milwaukie Business Park located in Milwaukie, Oregon, for net proceeds of $10.6 million, which resulted in a net gain of $7.6 million. The park consists of six multi-tenant flex buildings aggregating 102,000 square feet.

The Company has a 125,000 square foot building, which sits on a five-acre parcel of land within the Company's Westpark Business Park in Tysons, Virginia, classified as land and building held for development. The Company previously entered into a joint venture, in which it has a 95.0% economic interest, with a real estate development company for the purpose of developing a 395-unit multi-family building on this site. Having obtained all the required entitlements and site plan approvals necessary to proceed with construction, subsequent to September 30, 2015, the Company contributed the property to the joint venture and commenced demolition and site preparation. The land and capitalized development costs were $21.2 million and $18.4 million at September 30, 2015 and December 31, 2014, respectively. For the nine months ended September 30, 2015, the Company capitalized costs of $2.8 million related to this development, of which $813,000 were capitalized interest costs.

4. Leasing activity

The Company leases space in its real estate facilities to tenants primarily under non-cancelable leases generally ranging from one to 10 years. Future minimum rental revenues, excluding recovery of operating expenses under these leases, are as follows as of September 30, 2015 (in thousands):

2015	$ 70,249
2016	246,371
2017	181,827
2018	131,249
2019	89,435
Thereafter	157,220
Total	$ 876,351

In addition to minimum rental payments, certain tenants reimburse the Company for their pro rata share of specified operating expenses. Such reimbursements amounted to $19.5 million and $20.7 million for the three months ended

September 30, 2015 and 2014, respectively, and $59.5 million and $61.5 million for the nine months ended September 30, 2015 and 2014, respectively. These amounts are included as rental income in the accompanying consolidated statements of income.

Leases accounting for 3.6% of total leased square footage are subject to termination options, of which 1.1% of total leased square footage have termination options exercisable through December 31, 2015 (unaudited). In general, these leases provide for termination payments should the termination options be exercised. The future minimum rental revenues in the above table assume such options are not exercised.

5. Bank loans

The Company has a line of credit (the “Credit Facility”) with Wells Fargo Bank, National Association (“Wells Fargo”). The Credit Facility has a borrowing limit of $250.0 million and expires May 1, 2019. The rate of interest charged on borrowings is based on 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 September 30, 2015 and December 31, 2014. The Company had $827,000 and $1.0 million of unamortized commitment fees as of September 30, 2015 and December 31, 2014, respectively. The

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Credit Facility requires the Company to meet certain covenants, all of which the Company was in compliance with as of September 30, 2015. Interest on outstanding borrowings is payable monthly.

6. Mortgage note payable

The Company has a $250.0 million mortgage note payable with a fixed interest rate of 5.45% secured by 4.8 million square feet of commercial properties with a net book value of $420.4 million at September 30, 2015. The interest is payable monthly with a maturity date of December 1, 2016, prepayable without penalty on June 1, 2016.

7. Noncontrolling interests

As described in Note 2, the Company reports noncontrolling interests within equity in the consolidated financial statements, but separate from the Company's shareholders' equity. In addition, net income allocable to noncontrolling interests is shown as a reduction from net income in calculating net income allocable to common shareholders.

Common partnership units

The Company presents the accounts of PSB and the Operating Partnership on a consolidated basis. Ownership interests in the Operating Partnership that can be redeemed for common stock, other than PSB's interest, are classified as noncontrolling interests—common units in the consolidated financial statements. Net income allocable to noncontrolling interests—common units consists of the common units' share of the consolidated operating results after allocation to preferred units and shares. Beginning one year from the date of admission as a limited partner (common units) and subject to certain limitations described below, each limited partner other than PSB has the right to require the redemption of its partnership interest.

A limited partner (common units) that exercises its redemption right will receive cash from the Operating Partnership in an amount equal to the market value (as defined in the Operating Partnership Agreement) of the partnership interests redeemed. In lieu of the Operating Partnership redeeming the common units for cash, PSB, as general partner, has the right to elect to acquire the partnership interest directly from a limited partner exercising its redemption right, in exchange for cash in the amount specified above or by issuance of one share of PSB common stock for each unit of limited partnership interest redeemed.

A limited partner (common units) cannot exercise its redemption right if delivery of shares of PSB common stock would be prohibited under the applicable articles of incorporation, or if the general partner believes that there is a risk that delivery of shares of common stock would cause the general partner to no longer qualify as a REIT, would cause a violation of the applicable securities laws, or would result in the Operating Partnership no longer being treated as a partnership for federal income tax purposes.

At September 30, 2015, there were 7,305,355 common units owned by PS, which are accounted for as noncontrolling interests. Combined with PS's existing common stock ownership, on a fully converted basis, PS has a combined ownership of 42.1% (or 14.5 million shares) of the Company's common equity.

8. Related party transactions

The Operating Partnership manages industrial, office and retail facilities for PS. These facilities, all located in the United States, operate under the "Public Storage" or "PS Business Parks" names. 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.

Under the property management contract with PS, the Operating Partnership is compensated based on a percentage of the gross revenues of the facilities managed. Under the supervision of the property owners, the Operating Partnership coordinates rental policies, rent collections, marketing activities, the purchase of equipment and supplies, maintenance activities, and the selection and engagement of vendors, suppliers and independent contractors. In addition, the Operating Partnership assists and advises the property owners in establishing policies for the hire, discharge and supervision of employees for the operation of these facilities, including property managers and leasing, billing and maintenance personnel.

The property management contract with 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 revenues under this contract were $130,000 and $164,000 for the three months ended September 30, 2015 and 2014, respectively, and $410,000 and $495,000 for the nine months ended September 30, 2015 and 2014, 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.

Under the property management contract, PS is compensated based on a percentage of the gross revenues of the facilities managed. Under the supervision of the Company, PS coordinates rental policies, rent collections, marketing activities, the purchase of equipment and supplies, maintenance activities, and the selection and engagement of vendors, suppliers and independent contractors. In addition, PS is responsible for establishing the policies for the hire, discharge and supervision of employees for the operation of these facilities, including on-site managers, assistant managers and associate managers.

Either the Company or PS can cancel the property management contract upon 60 days’ notice. Management fee expenses under the contract were $21,000 and $18,000 for the three months ended September 30, 2015 and 2014, respectively, and $59,000 and $52,000 for the nine months ended September 30, 2015 and 2014, respectively.

Pursuant to a cost sharing and administrative services agreement, the Company shares costs with PS for certain administrative services and rental of corporate office space, which are allocated to PS in accordance with a methodology intended to fairly allocate those costs. These costs totaled $117,000 and $113,000 for the three months ended September 30, 2015 and 2014, respectively, and $352,000 and $338,000 for the nine months ended September 30, 2015 and 2014, respectively.

The Company had net amounts due to PS of $320,000 at September 30, 2015 and due from PS of $166,000 December 31, 2014, respectively, for these contracts, as well as for certain operating expenses paid by the Company on behalf of PS.

9. Shareholders’ equity

Preferred stock

As of September 30, 2015 and December 31, 2014, the Company had the following series of preferred stock outstanding:

				September 30, 2015		December 31, 2014	
		Earliest Potential	Dividend	Shares	Amount	Shares	Amount
Series	Issuance Date	Redemption Date	Rate	Outstanding	(in thousands)	Outstanding	(in thousands)
Series S	January, 2012	January, 2017	6.450%	9,200	$ 230,000	9,200	$ 230,000
Series T	May, 2012	May, 2017	6.000%	14,000	350,000	14,000	350,000
Series U	September, 2012	September, 2017	5.750%	9,200	230,000	9,200	230,000
Series V	March, 2013	March, 2018	5.700%	4,400	110,000	4,400	110,000
Series R	October, 2010	October, 2015	6.875%				