Douglas Emmett Inc
Form 10-Q
May 08, 2009

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 March 31, 2009

Commission file number 001-33106

DOUGLAS EMMETT, INC.
(Exact name of registrant as specified in its charter)

MARYLAND (State or other jurisdiction of incorporation or organization)	20-3073047 (I.R.S. Employer Identification No.)
808 Wilshire Boulevard, Suite 200, Santa Monica, California (Address of principal executive offices)	90401 (Zip Code)

(310) 255-7700
(Registrant's telephone number, including area code)

None
(Former name, former address and former fiscal year, if changed since last report)

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

Yes x No o

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 such shorter period that the registrant was required to submit and post such files).

Yes o No o

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. (Check one):

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No x

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practicable date.

Class	Outstanding at April 30, 2009
Common Shares of beneficial interest, $0.01 par value per share	121,299,341 shares

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Douglas Emmett, Inc.
Consolidated Balance Sheets
(unaudited and in thousands, except for share data)

	March 31, 2009	December 31, 2008
Assets		
Investment in real estate:		
Land	$ 835,366	$ 900,213
Buildings and improvements	5,011,643	5,528,567
Tenant improvements and lease intangibles	506,386	552,536
	6,353,395	6,981,316
Less: accumulated depreciation	(522,864)	(490,125)
Net investment in real estate	5,830,531	6,491,191
Cash and cash equivalents	29,827	8,655
Tenant receivables, net	1,189	2,197
Deferred rent receivables, net	33,436	33,039
Interest rate contracts	165,311	176,255
Acquired lease intangible assets, net	15,632	18,163
Investment in unconsolidated real estate fund	100,775	
Other assets	28,891	31,304
Total assets	$ 6,205,592	$ 6,760,804
Liabilities		
Secured notes payable, including loan premium	$ 3,277,256	$ 3,692,785
Accounts payable and accrued expenses	71,298	69,215
Security deposits	32,500	35,890
Acquired lease intangible liabilities, net	165,649	195,036
Interest rate contracts	359,360	407,492
Dividends payable	12,150	22,856
Other liabilities		57,316
Total liabilities	3,918,213	4,480,590
Equity		
Douglas Emmett, Inc. stockholders' equity:		
Common stock, $0.01 par value 750,000,000 authorized, 121,499,341 and 121,897,388 outstanding at March 31, 2009 and December 31, 2008, respectively.	1,215	1,219
Additional paid-in capital	2,284,999	2,284,429
Accumulated other comprehensive income	(251,666)	(274,111)
Accumulated deficit	(250,364)	(236,348)
Total Douglas Emmett, Inc. stockholders' equity	1,784,184	1,775,189
Noncontrolling interests	503,195	505,025

Total equity		2,287,379		2,280,214
Total liabilities and equity	$	6,205,592	$	6,760,804

See notes to consolidated financial statements.

Douglas Emmett, Inc.
Consolidated Statements of Operations
(unaudited and in thousands, except for share data)

	Three Months Ended March 31, 2009	2008
Revenues		
Office rental:		
Rental revenues	$ 108,546	$ 99,016
Tenant recoveries	7,966	6,009
Parking and other income	17,634	16,576
Total office revenues	134,146	121,601
Multifamily rental:		
Rental revenues	16,187	17,224
Parking and other income	1,084	983
Total multifamily revenues	17,271	18,207
Total revenues	151,417	139,808
Operating expenses		
Office expense	40,312	35,921
Multifamily expense	4,517	4,300
General and administrative	6,351	5,285
Depreciation and amortization	61,074	56,749
Total operating expenses	112,254	102,255
Operating income	39,163	37,553
Gain on disposition of interest in unconsolidated real estate fund	5,573	
Interest and other income	2,914	409
Loss, including depreciation, from unconsolidated real estate fund	(678)	
Interest expense	(49,222)	(41,203)
Net loss	(2,250)	(3,241)
Less: Net loss attributable to noncontrolling interests	383	741
Net loss attributable to common stockholders	$ (1,867)	$ (2,500)
Net loss attributable to common stockholders per share – basic and diluted	$ (0.02)	$ (0.02)
Dividends declared per common share	$ 0.10	$ 0.1875
Weighted average shares of common stock outstanding – basic and diluted	121,841,789	118,283,579

See notes to consolidated financial statements.

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Douglas Emmett, Inc.
Consolidated Statements of Cash Flows
(unaudited and in thousands)

	Three Months Ended March 31, 2009	Three Months Ended March 31, 2008
Operating Activities		
Net loss	$ (2,250)	$ (3,241)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Non-cash profit sharing allocation to consolidated fund	660	
Loss, including depreciation, from unconsolidated real estate fund	678	
Depreciation and amortization	61,074	56,749
Net accretion of acquired lease intangibles	(10,101)	(10,198)
Gain on disposition of interest in unconsolidated real estate fund	(5,573)	
Amortization of deferred loan costs	607	362
Amortization of loan premium	(1,229)	(1,160)
Non-cash market value adjustments on interest rate contracts	4,964	1,800
Non-cash amortization of stock-based compensation	2,489	3,291
Change in working capital components:		
Tenant receivables	864	703
Deferred rent receivables	(2,003)	(4,271)
Accounts payable, accrued expenses and security deposits	8,224	3,282
Other	(3,492)	6,726
Net cash provided by operating activities	54,912	54,043
Investing Activities		
Capital expenditures and property acquisitions	(11,101)	(627,103)
Deconsolidation of Douglas Emmett Fund X, LLC	(6,625)	
Net cash used in investing activities	(17,726)	(627,103)
Financing Activities		
Proceeds from long-term borrowings	82,640	833,850
Deferred loan costs	(3)	(2,010)
Repayment of borrowings	(106,665)	(205,000)
Net change in short-term borrowings	(25,275)	(4,000)
Contributions by Douglas Emmett Fund X, LLC investors	66,074	
Contributions by noncontrolling interests	450	100
Distributions to noncontrolling interests	(6,478)	(8,251)
Redemption of noncontrolling interests		(23,758)
Repurchase of common stock	(3,901)	
Cash dividends	(22,856)	(19,221)
Net cash (used in) provided by financing activities	(16,014)	571,710
Increase (decrease) in cash and cash equivalents	21,172	(1,350)
Cash and cash equivalents at beginning of period	8,655	5,843

Cash and cash equivalents at end of period	$	29,827	$	4,493
Noncash transactions				
Investing activity related to contribution of properties				
to unconsolidated real estate fund	$	476,852	$	
Financing activity related to contribution of debt and				
noncontrolling interest to unconsolidated real estate fund	$	(483,477)	$	

See notes to consolidated financial statements.

Douglas Emmett, Inc.
Notes to Consolidated Financial Statements
(in thousands, except shares and per share data)

1. Overview

Organization and Description of Business

Douglas Emmett, Inc., a Maryland corporation incorporated on June 28, 2005, is a fully integrated, self-administered and self-managed Real Estate Investment Trust (REIT). Through our interest in Douglas Emmett Properties, LP (our operating partnership) and our subsidiaries, we own, manage, lease, acquire and develop real estate. As of March 31, 2009, we owned a portfolio of 49 office properties (including ancillary retail space) and nine multifamily properties, as well as the fee interests in two parcels of land that we lease to third parties. All properties are 100% owned except Honolulu Club (78,000 square feet) which is owned by a joint venture in which we own a 66.7% interest. We also own an interest in six additional properties totaling 1.4 million square feet owned by an unconsolidated real estate fund, Douglas Emmett Fund X, LLC (Fund X) in which we own an equity interest. All of these properties are located in Los Angeles County, California and Honolulu, Hawaii. We qualified as a REIT for federal income tax purposes beginning with our initial taxable year ending December 31, 2006 and expect to maintain such qualification.

We are one of the largest owners and operators of high-quality office and multifamily properties in Los Angeles County, California and in Honolulu, Hawaii. Our presence in Los Angeles and Honolulu is the result of a consistent and focused strategy of identifying submarkets that are supply constrained, have high barriers to entry and typically exhibit strong economic characteristics such as population and job growth and a diverse economic base. In our office portfolio, we focus primarily on owning and acquiring a substantial share of top-tier office properties within submarkets located near high-end executive housing and key lifestyle amenities. In our multifamily portfolio, we focus primarily on owning and acquiring select properties at premier locations within these same submarkets. Our properties are concentrated in nine premier Los Angeles County submarkets—Brentwood, Olympic Corridor, Century City, Santa Monica, Beverly Hills, Westwood, Sherman Oaks/Encino, Warner Center/Woodland Hills and Burbank—as well as in Honolulu, Hawaii.

Douglas Emmett, Inc.
Notes to Consolidated Financial Statements--(continued)
(in thousands, except shares and per share data)

Basis of Presentation
The accompanying consolidated financial statements as of March 31, 2009 and December 31, 2008 and for the three months ended March 31, 2009 and 2008 are the consolidated financial statements of Douglas Emmett, Inc. and our subsidiaries including our operating partnership. As described in Note 2 below, the results of the six properties acquired in March 2008 were included in our consolidated results until the end of February 2009, when we completed the transaction to contribute these properties to Fund X in return for an equity interest. All significant intercompany balances and transactions have been eliminated in our consolidated financial statements. Certain prior period amounts have been reclassified to conform with current period presentation.

The accompanying unaudited interim financial statements have been prepared pursuant to the rules and regulations of the U.S. Securities and Exchange Commission (SEC). Certain information and footnote disclosure normally included in the financial statements prepared in accordance with accounting principles generally accepted in the United States (GAAP) may have been condensed or omitted pursuant to SEC rules and regulations, although we believe that the disclosures are adequate to make their presentation not misleading. The accompanying unaudited financial statements include, in our opinion, all adjustments, consisting of normal recurring adjustments, necessary to present fairly the financial information set forth therein. The results of operations for the interim periods are not necessarily indicative of the results that may be expected for the year ended December 31, 2009. The interim financial statements should be read in conjunction with the consolidated financial statements in our 2008 Annual Report on Form 10-K and notes thereto. Any reference to the number of properties and square footage are unaudited and outside the scope of our independent registered public accounting firm's review of our financial statements in accordance with the standards of the United States Public Company Accounting Oversight Board.

The preparation of financial statements in conformity with GAAP requires us to make certain estimates and assumptions, for example with respect to the allocation of the purchase price of acquisitions among land, buildings, improvements, equipment and any related intangible assets and liabilities. These estimates and assumptions are subjective and affect the reported amounts in the consolidated financial statements and accompanying notes. Actual results could differ materially from those estimates.

Douglas Emmett, Inc.
Notes to Consolidated Financial Statements--(continued)
(in thousands, except shares and per share data)

2. Acquisitions, Dispositions and Other Transfers

We did not make any acquisitions during the quarter ended March 31, 2009.

On February 13, 2008, we acquired a two-thirds interest in a 78,298 square-foot office building located in Honolulu, Hawaii. As part of the same transaction, we also acquired all of the assets of The Honolulu Club, a private membership athletic and social club, which is located in the building. The aggregate contract price was approximately $18 million and the purchase was made through a consolidated joint venture with our local partner. The joint venture financed the acquisition with an $18 million loan. See Note 7 for a description of the debt. On May 1, 2008, the operations of the athletic club were sold to a third party for a nominal cost. Simultaneously, the acquirer leased from us the space occupied by the athletic club. The results of operations and loss on sale of the assets of the athletic club were not material.

On March 26, 2008, we acquired a 1.4 million square foot office portfolio consisting of six Class A buildings all located in our core Los Angeles submarkets – Santa Monica, Beverly Hills, Sherman Oaks/Encino and Warner Center/Woodland Hills – for a contract price of approximately $610 million. Subsequent to acquiring the properties, we entered into a non-recourse $365 million term loan secured by the six-property portfolio. See Note 7 for a description of the debt. In October 2008, we completed the initial closing of Fund X.

In connection with the initial closing of Fund X, (i) we contributed to Fund X the portfolio of six Class A office properties that we acquired in March 2008 and (ii) we transferred to Fund X the related 5-year, $365 million term loan. In exchange, we received an interest in the common equity of Fund X. As the net value of the contributed properties (as valued under the Fund X operating agreement) exceeded our required capital contribution, the Fund was obligated to distribute cash to us for the excess. We received a partial cash distribution from Fund X in October 2008, shortly after the initial closing. At the end of February 2009, we received a second cash distribution for the remainder of the excess, at which point Fund X became an unconsolidated real estate fund in which we retained an equity investment of $100,775 at March 31, 2009 and recognized a gain of $5,573 on the disposition of the interest in Fund X we did not retain.

The results of operations for each of the acquired properties are included in our consolidated statements of operations only from the date of each acquisition, and in the case of the properties contributed to Fund X, only until the end of February 2009, when the properties were deconsolidated from our financial statements.

Douglas Emmett, Inc.
Notes to Consolidated Financial Statements--(continued)
(in thousands, except shares and per share data)

3. Segment Reporting

Financial Accounting Standard (FAS) No. 131, Disclosures about Segments of an Enterprise and Related Information, established standards for disclosure about operating segments and related disclosures about products and services, geographic areas and major customers. Segment information is prepared on the same basis that our management reviews information for operational decision-making purposes. We operate in two business segments: (i) the acquisition, redevelopment, ownership and management of office real estate and (ii) the acquisition, redevelopment, ownership and management of multifamily real estate. The products for our office segment primarily include rental of office space and other tenant services including parking and storage space rental. The products for our multifamily segment include rental of apartments and other tenant services including parking and storage space rental.

Asset information by segment is not reported because we do not use this measure to assess performance and make decisions to allocate resources. Therefore, depreciation and amortization expense is not allocated among segments. Interest and other income, management services, general and administrative expenses, interest expense, depreciation and amortization expense and net derivative gains and losses are not included in rental revenues less rental expenses as our internal reporting addresses these items on a corporate level.

Rental revenues less rental expenses is not a measure of operating results or cash flows from operating activities as measured by GAAP, and it is not indicative of cash available to fund cash needs and should not be considered an alternative to cash flows as a measure of liquidity. Not all companies may calculate rental revenues less rental expenses in the same manner. We consider rental revenues less rental expenses to be an appropriate supplemental measure to net income because it assists both investors and management in understanding the core operations of our properties.

Douglas Emmett, Inc.
Notes to Consolidated Financial Statements--(continued)
(in thousands, except shares and per share data)

The following table represents operating activity within our reportable segments:

	Three Months Ended March 31, 2009			Three Months Ended March 31, 2008		
	Office	Multifamily	Total	Office	Multifamily	Total
Rental revenues	$ 134,146	$ 17,271	$ 151,417	$ 121,601	$ 18,207	$ 139,808
Percentage of total	89%	11%	100%	87%	13%	100%
Rental expenses	$ 40,312	$ 4,517	$ 44,829	$ 35,921	$ 4,300	$ 40,221
Percentage of total	90%	10%	100%	89%	11%	100%
Rental revenues less rental expenses	$ 93,834	$ 12,754	$ 106,588	$ 85,680	$ 13,907	$ 99,587
Percentage of total	88%	12%	100%	86%	14%	100%

The following is a reconciliation of rental revenues less rental expenses to net loss:

	Three Months Ended March 31, 2009	Three Months Ended March 31, 2008
Rental revenues less rental expenses	$ 106,588	$ 99,587
General and administrative expenses	(6,351)	(5,285)
Depreciation and amortization	(61,074)	(56,749)
Gain on disposition of interest in unconsolidated real estate fund	5,573	
Interest and other income	2,914	409
Loss, including depreciation, from unconsolidated real estate fund	(678)	
Interest expense	(49,222)	(41,203)
Net loss	(2,250)	(3,241)
Less: Net loss attributable to noncontrolling interests	383	741
Net loss attributable to common stockholders	$ (1,867)	$ (2,500)

Douglas Emmett, Inc.
Notes to Consolidated Financial Statements--(continued)
(in thousands, except shares and per share data)

4. Other Assets

Other assets consist of the following at:

	March 31, 2009	December 31, 2008
Deferred loan costs, net of accumulated amortization of $3,578 and $3,336 at March 31, 2009 and December 31, 2008, respectively	$ 5,787	$ 9,714
Restricted cash	2,937	2,934
Prepaid interest	3,916	4,360
Prepaid expenses	2,820	3,845
Interest receivable	9,120	5,938
Other indefinite-lived intangible	1,988	1,988
Other	2,323	2,525
	$ 28,891	$ 31,304

We incurred deferred loan cost amortization expense of $607 and $362 for the three months ended March 31, 2009 and 2008, respectively. The deferred loan cost amortization is included as a component of interest expense in the consolidated statements of operations.

5. Accounts Payable and Accrued Expenses

Accounts payable and accrued expenses consist of the following as of:

	March 31, 2009	December 31, 2008
Accounts payable	$ 30,799	$ 30,199
Accrued interest payable	26,165	22,982
Deferred revenue	14,334	16,034
	$ 71,298	$ 69,215

6. Acquired Lease Intangibles

Our acquired lease intangibles related to above/below-market leases is summarized as of:

	March 31, 2009	December 31, 2008
Above-market tenant leases	$ 32,770	$ 34,227
Accumulated amortization	(20,149)	(19,094)
Below-market ground leases	3,198	3,198
Accumulated amortization	(187)	(168)