ANTERO RESOURCES Corp
Form 10-Q
April 27, 2016
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2016

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: 001-36120

ANTERO RESOURCES CORPORATION

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	80-0162034 (IRS Employer Identification No.)
1615 Wynkoop Street Denver, Colorado (Address of principal executive offices)	80202 (Zip Code)

(303) 357-7310

(Registrant's telephone number, including area code)

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

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

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

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

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

The registrant had 277,408,453 shares of common stock outstanding as of April 25, 2016.

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

The information in this report includes “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). All statements, other than statements of historical fact included in this Quarterly Report on Form 10-Q, regarding our strategy, future operations, financial position, estimated revenues and losses, projected costs, prospects, plans and objectives of management are forward-looking statements. When used, the words “could,” “believe,” “anticipate,” “intend,” “estimate,” “expect,” “project” and similar expressions are intended to identify forward-looki statements, although not all forward-looking statements contain such identifying words. These forward-looking statements are based on our current expectations and assumptions about future events and are based on currently available information as to the outcome and timing of future events. When considering forward-looking statements, you should keep in mind the risk factors and other cautionary statements described under the heading “Item 1A. Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2015 (our “2015 Form 10-K”) on file with the Securities and Exchange Commission (the “SEC”) and in “Item 1A. Risk Factors” of this Quarterly Report on Form 10-Q.

Forward-looking statements may include statements about our:

· business strategy;

· reserves;

· financial strategy, liquidity, and capital required for our development program;

· natural gas, natural gas liquids (“NGLs”), and oil prices;

· timing and amount of future production of natural gas, NGLs, and oil;

· hedging strategy and results;

· ability to meet our minimum volume commitments and to utilize or monetize our firm transportation commitments;

· future drilling plans;

· competition and government regulations;

- pending legal or environmental matters;
- marketing of natural gas, NGLs, and oil;
- leasehold or business acquisitions;
- costs of developing our properties;
- operations of Antero Midstream Partners LP;
- general economic conditions;
- credit markets;
- uncertainty regarding our future operating results; and
- plans, objectives, expectations, and intentions.

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We caution you that these forward-looking statements are subject to all of the risks and uncertainties, most of which are difficult to predict and many of which are beyond our control, incident to the exploration for and development, production, gathering, processing, transportation, and sale of natural gas, NGLs, and oil. These risks include, but are not limited to, commodity price volatility and continued low commodity prices, inflation, lack of availability of drilling and production equipment and services, environmental risks, drilling and other operating risks, marketing and transportation risks, regulatory changes, the uncertainty inherent in estimating natural gas, NGLs, and oil reserves and in projecting future rates of production, cash flow and access to capital, the timing of development expenditures, and the other risks described under the heading “Item 1A. Risk Factors” in our 2015 Form 10-K on file with the SEC and in “Item 1A. Risk Factors” of this Quarterly Report on Form 10-Q.

Reserve engineering is a process of estimating underground accumulations of natural gas, NGLs, and oil that cannot be measured in an exact way. The accuracy of any reserve estimate depends on the quality of available data, the interpretation of such data and price and cost assumptions made by reservoir engineers. In addition, the results of drilling, testing and production activities, or changes in commodity prices, may justify revisions of estimates that were made previously. If significant, such revisions would change the schedule of any further production and development drilling. Accordingly, reserve estimates may differ significantly from the quantities of natural gas, NGLs, and oil that are ultimately recovered.

Should one or more of the risks or uncertainties described in this report occur, or should underlying assumptions prove incorrect, our actual results and plans could differ materially from those expressed in any forward-looking statements.

All forward-looking statements, expressed or implied, included in this report are expressly qualified in their entirety by this cautionary statement. This cautionary statement should also be considered in connection with any subsequent written or oral forward-looking statements that we or persons acting on our behalf may issue.

Except as otherwise required by applicable law, we disclaim any duty to update any forward-looking statements, all of which are expressly qualified by the statements in this section, to reflect events or circumstances after the date of this Quarterly Report on Form 10-Q.

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PART I—FINANCIAL INFORMATION

ANTERO RESOURCES CORPORATION

Condensed Consolidated Balance Sheets

December 31, 2015 and March 31, 2016

(Unaudited)

(In thousands, except share amounts)

	2015	2016
Assets		
Current assets:		
Cash and cash equivalents	$ 23,473	39,870
Accounts receivable, net of allowance for doubtful accounts of $1,195 in 2015 and 2016	79,404	78,753
Accrued revenue	128,242	136,446
Derivative instruments	1,009,030	975,199
Other current assets	8,087	8,072
Total current assets	1,248,236	1,238,340
Property and equipment:		
Natural gas properties, at cost (successful efforts method):		
Unproved properties	1,996,081	1,994,377
Proved properties	8,211,106	8,531,113
Water handling and treatment systems	565,616	582,331
Gathering systems and facilities	1,502,396	1,543,766
Other property and equipment	46,415	46,741
	12,321,614	12,698,328
Less accumulated depletion, depreciation, and amortization	(1,589,372)	(1,780,526)
Property and equipment, net	10,732,242	10,917,802
Derivative instruments	2,108,450	2,098,233
Other assets	26,565	34,337
Total assets	$ 14,115,493	14,288,712
Liabilities and Equity		
Current liabilities:		
Accounts payable	$ 364,160	250,797
Accrued liabilities	194,076	241,676
Revenue distributions payable	129,949	132,918
Other current liabilities	19,085	19,693
Total current liabilities	707,270	645,084
Long-term liabilities:		

Long-term debt	4,668,782	4,702,809
Deferred income tax liability	1,370,686	1,439,825
Derivative instruments	—	375
Other liabilities	82,077	80,275
Total liabilities	6,828,815	6,868,368
Commitments and contingencies (notes 9 and 13)		
Equity:		
Stockholders' equity:		
Preferred stock, $0.01 par value; authorized - 50,000,000 shares; none issued	—	—
Common stock, $0.01 par value; authorized - 1,000,000,000 shares; issued and outstanding 277,035,558 shares and 277,061,336 shares, respectively	2,770	2,771
Additional paid-in capital	4,122,811	4,251,755
Accumulated earnings	1,808,811	1,803,756
Total stockholders' equity	5,934,392	6,058,282
Noncontrolling interest in consolidated subsidiary	1,352,286	1,362,062
Total equity	7,286,678	7,420,344
Total liabilities and equity	$ 14,115,493	14,288,712

See accompanying notes to condensed consolidated financial statements.

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ANTERO RESOURCES CORPORATION

Condensed Consolidated Statements of Operations and Comprehensive Income (Loss)

Three Months Ended March 31, 2015 and 2016

(Unaudited)

(In thousands, except share and per share amounts)

	2015	2016
Revenue:		
Natural gas sales	$ 314,942	254,776
Natural gas liquids sales	78,786	73,065
Oil sales	12,457	10,179
Gathering, compression, and water handling	6,168	3,844
Marketing	57,780	99,216
Commodity derivative fair value gains	759,554	279,924
Total revenue	1,229,687	721,004
Operating expenses:		
Lease operating	8,102	11,293
Gathering, compression, processing, and transportation	163,662	208,738
Production and ad valorem taxes	24,218	19,284
Marketing	73,349	137,933
Exploration	1,371	1,014
Impairment of unproved properties	8,577	15,526
Depletion, depreciation, and amortization	182,300	191,582
Accretion of asset retirement obligations	400	598
General and administrative (including equity-based compensation expense of $27,783 and $23,470 in 2015 and 2016, respectively)	59,049	56,287
Contract termination and rig stacking	8,965	—
Total operating expenses	529,993	642,255
Operating income	699,694	78,749
Other expenses:		
Interest	(53,185)	(63,284)
Income before income taxes	646,509	15,465
Provision for income tax expense	(247,338)	(4,815)
Net income and comprehensive income including noncontrolling interest	399,171	10,650
Net income and comprehensive income attributable to noncontrolling interest	4,740	15,705
Net income (loss) and comprehensive income (loss) attributable to Antero Resources Corporation	$ 394,431	(5,055)
Earnings (loss) per common share	$ 1.49	(0.02)
Earnings (loss) per common share—assuming dilution	$ 1.49	(0.02)
Weighted average number of shares outstanding:		

Basic	265,294,794	277,050,344
Diluted	265,300,080	277,050,344

See accompanying notes to condensed consolidated financial statements.

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ANTERO RESOURCES CORPORATION

Condensed Consolidated Statements of Equity

Three Months Ended March 31, 2016

(Unaudited)

(In thousands)

Common Stock		Additional paid-	Accumulated	Noncontrolling Total	
14	87.32	1,272,827	57,640,735	4,652,083	
St. Louis, Missouri	13	85.05	1,251,825	38,309,893	7,932,787
Tampa, Florida	64	90.97	3,906,175	151,484,260	26,990,563
Tulsa, Oklahoma	9	96.42	523,623	12,533,713	
Washington D.C./ Baltimore, Maryland	42	93.01	4,221,518	175,979,160	50,442,077
Other(8)	2	100.00	215,723	4,995,993	390,730
Mexico:					
Juarez	12	92.13	966,918	36,511,743	
Monterrey	6	100.00	582,663	23,913,216	
Reynosa	11	74.43	967,041	34,749,507	
Tijuana	2	100.00	262,220	9,476,027	
Subtotal North America(5)	1,202	86.86	123,356,030	4,224,960,134	555,689,183
European Markets(9):					
France:					
North	1	0.00	192,977	7,780,588	
South	2	34.44	560,718	18,403,705	
Germany:					
Rhine/ Ruhr	1	0.00	176,121	9,885,191	
Netherlands:					
South	1	0.00	456,760	19,669,313	
Poland:					
South	1	100.00	123,000	3,288,943	
Spain:					
Madrid	2	0.00	608,467	27,541,457	
United Kingdom:					
East Midlands	11	18.49	1,137,453	127,165,729	
London and Southeast	5	0.00	509,423	68,832,669	
North	1	0.00	185,123	14,103,901	
West Midlands	3	27.69	649,996	46,242,057	
Subtotal Europe(9)	28	15.36	4,600,038	342,913,553	
Total Operating Properties Directly Owned at December 31, 2002(4)	**1,230**	**84.29%**	**127,956,068**	**$4,567,873,687**	**$555,689,183**

No. of Bldgs.	**Rentable Square Footage**	**Investment (2)**	**Total Expected Cost (10)**

Properties Under Development at December 31, 2002(11)(12):				
North American Markets:				
United States:				
Denver, Colorado	1	95,700	$ 2,218,101	$ 4,532,693
El Paso, Texas	1	53,240	1,065,827	1,959,452
Ft. Lauderdale/ Miami, Florida	1	164,511	6,952,728	8,427,327
Houston, Texas	2	153,600	4,364,068	5,897,186
Los Angeles/ Orange County, California	1	1,056,484	25,867,107	38,060,512

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	No. of Bldgs.	Rentable Square Footage	Investment (2)	Total Expected Cost (10)
Nashville, Tennessee	1	301,440	3,469,975	8,275,945
San Antonio, Texas	1	136,987	1,249,760	5,397,995
St. Louis, Missouri	1	1,262,648	26,202,112	37,159,396
Mexico:				
Monterrey	2	242,338	3,965,282	9,655,297
Subtotal North America	11	3,466,948	75,354,960	119,365,803
European Markets:				
Czech Republic:				
Prague	1	284,719	7,735,938	12,435,047
France:				
Central	1	213,988	5,235,629	9,479,206
North	1	344,760	6,750,645	10,867,276
South	1	282,275	5,687,003	10,353,036
Germany:				
Rhine/ Mein	1	227,938	15,084,972	16,636,824
Rhine/ Ruhr	1	122,473	1,571,259	6,852,715
Italy:				
Milan	3	783,867	14,608,928	36,088,956
Poland:				
Warsaw	1	283,911	6,984,853	9,565,097
West	1	63,938	1,370,087	2,355,642
United Kingdom:				
East Midlands	1	150,000	4,671,367	9,773,943
London and Southeast	9	1,779,034	99,401,394	197,831,680
West Midlands	1	113,000	12,450,845	13,870,097
Subtotal Europe	22	4,649,903	181,552,920	336,109,519
Asian Market:				
Tokyo, Japan	4	1,531,492	120,475,886	227,520,218
Total Properties Under Development at December 31, 2002(11)(12)	**37**	**9,648,343**	**$ 377,383,766**	**$ 682,995,540**

	Acreage	Investment (2)	Encumbrances (3)
Land Held for Development at December 31, 2002(13):			
North American Markets:			
United States:			
Atlanta, Georgia(14)	234.2	$ 19,266,615	$
Austin, Texas	7.2	764,367	
Charlotte, North Carolina	17.4	1,516,968	
Chicago, Illinois(15)	151.5	25,535,192	
Cincinnati, Ohio	100.1	8,816,354	
Columbus, Ohio	56.5	2,377,315	
Dallas/ Ft. Worth, Texas(16)	156.7	17,633,703	
El Paso, Texas	95.9	5,955,618	

Houston, Texas	56.4	5,231,419
I-81 Corridor, Pennsylvania	42.8	2,500,000
I-95 Corridor, New Jersey	10.1	817,943
Indianapolis, Indiana	123.4	8,616,824
Kansas City, Kansas/ Missouri	16.6	1,526,602

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	Acreage	Investment (2)	Encumbrances (3)
Las Vegas, Nevada	61.8	7,541,633	289,045
Los Angeles/ Orange County, California(17)	5.2	2,682,011	
Louisville, Kentucky	66.5	5,659,060	
Memphis, Tennessee	120.6	6,982,762	
Orlando, Florida	28.1	2,841,892	
Portland, Oregon	10.3	1,692,235	
Reno, Nevada	30.1	4,267,753	
Salt Lake City, Utah	30.4	2,027,560	
San Antonio, Texas	64.7	4,914,282	
San Francisco (East Bay) California	77.6	6,512,725	
Seattle, Washington	10.6	1,991,730	
Tampa, Florida	49.9	3,489,015	
Washington D.C./ Baltimore, Maryland	31.1	5,298,574	
Mexico:			
Juarez	47.2	7,755,978	
Monterrey	12.7	1,759,700	
Reynosa	80.8	10,081,468	
Tijuana	25.8	5,071,531	
Subtotal North America	1,822.2	181,128,829	289,045
European Markets:			
Belgium	9.2	760,671	
Czech Republic:			
Prague	37.0	9,778,312	
France:			
Central	24.0	3,977,254	
North	23.1	1,311,335	
South	24.7	5,804,341	
Germany:			
Rhine/ Mein	4.4	4,598,735	
Rhine/ Ruhr	19.7	4,917,537	
Hungary:			
Budapest	55.7	6,735,102	
Netherlands:			
Rotterdam	5.0	1,608,279	
Poland:			
Central	5.7	1,395,575	
South	19.1	2,548,699	
Warsaw	131.4	9,861,374	
West	5.8	1,024,147	
Spain:			
Madrid	33.3	9,374,530	
United Kingdom:			
East Midlands	44.4	14,200,486	
London and Southeast	50.4	56,474,671	
West Midlands	151.3	71,320,059	
Subtotal Europe	644.2	205,691,107	
Total Land Held for Development at December 31, 2002(13)	2,466.4	$386,819,936	$289,045

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	No. of Bldgs.	Acreage	Rentable Square Footage	Investment (2)	Total Expected Cost(10)	Encumbrances (3)
Grand Totals at December 31, 2002:						
Operating properties(4)(5)(7)	1,230	n/a	127,956,068	$4,567,873,687	n/a	$555,689,183
Properties under development	37	n/a	9,648,343	377,383,766	$682,995,540	
Land held for development	n/a	2,466.4	n/a	386,819,936	n/a	289,045
Other investments(18)	n/a	n/a	n/a	63,449,553	n/a	
Totals	1,267	2,466.4	137,604,411	$5,395,526,942	$682,995,540	$555,978,228

n/a Not Applicable

(1) The percentage occupancy presented is the physical occupancy at December 31, 2002. Operating properties at December 31, 2002 include recently completed development properties that may be in the initial lease-up phase, including properties aggregating 1.3 million square feet that were completed in the fourth quarter of 2002. The inclusion of properties in the initial lease-up phase can reduce the overall occupancy percentage.

(2) Represents the investment balance at December 31, 2002 and is ProLogis carrying value of the properties.

(3) Certain properties are pledged as security under ProLogis mortgage notes, securitized debt and assessment bonds at December 31, 2002. For purposes of this table, the total principal balance of a debt issuance that is secured by a pool of properties is allocated among the properties in the pool based on each property s investment balance. See Schedule III Real Estate and Accumulated Depreciation to ProLogis Consolidated Financial Statements in Item 8 for additional identification of the properties pledged.

(4) All operating properties are included in the property operations segment. See Item 1. Business ProLogis Operating Segments Property Operations Segment.

(5) Includes 67 properties aggregating 11.2 million square feet at an aggregate investment of $372.0 million that were developed in the CDFS business segment with the intent to contribute or sale the property or acquired with the intent to contribute the property to a property fund, including properties that have been or are being rehabilitated and/or repositioned utilizing CDFS business personnel that are pending contribution or a property fund or sale to a third party. See Item 1 Business ProLogis Operating Segments CDFS Business Segment.

(6) Includes one 0.2 million square foot property that was previously presented under the equity method in the temperature-controlled distribution segment. See Notes 2 and 4 to ProLogis Consolidated Financial Statements in Item 8.

(7) Includes three properties aggregating 0.5 million square feet that were previously presented under the equity method in the temperature-controlled distribution segment. See Notes 2 and 4 to ProLogis Consolidated Financial Statements in Item 8.

(8) Includes one property in each of Akron, Ohio and Brownsville, Texas.

(9) Includes 21 properties aggregating 4.1 million square feet at an aggregate investment of $291.0 million that were developed in the CDFS business segment that are pending contribution to a property fund or sale to a third party. See Item 1. Business ProLogis Operating Segments CDFS Business Segment.

(10) Represents the total expected cost at completion for properties under development, including the cost of land, fees, permits, payments to contractors, architectural and engineering fees and interest and property taxes to be capitalized during construction, rather than actual

costs incurred to date, as applicable.

(11) All of the properties under development are included in the CDFS business segment. See Item 1 Business ProLogis Operating Segments CDFS Business Segment.

(12) Includes properties aggregating 1.3 million square feet that are in the design and permitting stage.

(13) All of the land held for future development is included in the CDFS business segment. The land owned can be used for the development of approximately 44.2 million square feet of distribution properties. See Item 1 Business ProLogis Operating Segments CDFS Business Segment. Does not include 1,510 acres of land controlled directly by ProLogis under option, letter of intent or contingent contract with the capacity for developing approximately 24.8 million square feet of distribution properties.

(14) Includes approximately 33 acres of land that were previously presented under the equity method in the temperature-controlled distribution segment. See Notes 2 and 4 to ProLogis Consolidated Financial Statements in Item 8.

(15) Includes approximately six acres of land that were previously presented under the equity method in the temperature-controlled distribution segment. See Notes 2 and 4 to ProLogis Consolidated Financial Statements in Item 8.

(16) Includes approximately four acres of land that were previously presented under the equity method in the temperature-controlled distribution segment. See Notes 2 and 4 to ProLogis Consolidated Financial Statements in Item 8.

(17) Includes approximately five acres of land that were previously presented under the equity method in the temperature-controlled distribution segment. See Notes 2 and 4 to ProLogis Consolidated Financial Statements in Item 8.

(18) Other investments include: (i) restricted funds that are held in escrow pending the completion of tax-deferred exchange transactions involving operating properties ($6.9 million on deposit with third parties at December 31, 2002); (ii) earnest money deposits associated with potential acquisitions; (iii) costs incurred during the pre-acquisition due diligence process; and (iv) costs incurred during the pre-construction phase related to future development projects.

Real Estate Partnerships

At December 31, 2002, ProLogis held a majority interest in and controlled five real estate partnerships (collectively, the Partnerships). For financial reporting purposes, the assets, liabilities, results of operations and cash flows of each of the Partnerships are included in ProLogis Consolidated Financial Statements and in the preceding real estate tables. The interests of the limited partners are reflected as minority interest in ProLogis Consolidated Balance Sheet. See Note 6 to ProLogis Consolidated Financial Statements in Item 8.

Generally, pursuant to partnership agreements, ProLogis or a wholly owned subsidiary of ProLogis is the sole controlling general partner of each of the Partnerships with all management powers over the business and affairs of the Partnership. The limited partners of each Partnership generally do not have the authority to transact business for, or participate in the management decisions of, the Partnerships. The general partner in each of the Partnerships may not, without the written consent of all of the limited partners: (i) take any action that would prevent the Partnership from conducting its business; (ii) possess the property of the partnership; (iii) admit an additional partner; or (iv) subject a limited partner to the liability of a general partner. In each Partnership, ProLogis or its wholly owned subsidiary may not voluntarily withdraw from the Partnership or transfer or assign its interests in the Partnership without the consent of all of the limited partners. The limited partners may freely transfer their partnership units to their affiliates, provided that the transfer does not cause a termination of the Partnership under the Code and does not cause ProLogis to cease to comply with the REIT requirements under the Code. The limited partners in each of the Partnerships are entitled to redeem their partnership units for Common Shares. Additionally, the limited partners are entitled to receive preferential cumulative quarterly distributions per unit equal to the quarterly distributions paid on Common Shares.

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The Partnerships are as follows at December 31, 2002:

	Formation Date	Investment In Real Estate (in millions)	ProLogis Ownership	Limited Partnership Units Outstanding
ProLogis Limited Partnership-I	1993	$215.1(1)(2)	68.65%	4,520,532(3)(4)
ProLogis Limited Partnership-II	1994	60.8(5)	97.82%	90,213(3)
ProLogis Limited Partnership-III	1994	35.8(6)	95.25%	78,678(3)(7)
ProLogis Limited Partnership-IV(8)	1994	97.0(9)	98.52%	68,612(3)(7)
Meridian Realty Partners Limited Partnership	(10)	11.1(11)	87.00%	29,712(12)
		$419.8		4,787,747

(1) These properties cannot be sold, prior to the occurrence of certain events, without the consent of the limited partners, other than in tax-deferred exchanges.

(2) One property is located in the Tampa market; all other properties are located in the San Francisco (South Bay and East Bay) markets.

(3) Each unit is convertible into one Common Share.

(4) Entities in which Irving F. Lyons, III, ProLogis Vice Chairman and Chief Investment Officer has ownership interests owned 2,459,183 of the outstanding limited partnership units in ProLogis Limited Partnership-I at December 31, 2002 or 17.1% of ProLogis Limited Partnership-I s total units outstanding at December 31, 2002. Mr. Lyons effective ownership in ProLogis Partnership-I was 1.8% at December 31, 2002.

(5) These properties are located in the Charlotte, Dallas/ Ft. Worth, Denver, El Paso, San Francisco (East Bay), St. Louis and Washington, D.C./ Baltimore markets.

(6) These properties are located in the Chicago, Orlando, San Antonio and Tampa markets.

(7) Jeffrey H. Schwartz, ProLogis President of International Operations and President and Chief Operating Officer Asia, owned all of the outstanding limited partnership units in ProLogis Limited Partnership-III at December 31, 2002 or 4.75% of ProLogis Limited Partnership-III s total units outstanding at December 31, 2002 and 49,587 of the outstanding limited partnership units in ProLogis Limited Partnership-IV at December 31, 2002 or 1.07% of ProLogis Limited Partnership-IV s total units outstanding at December 31, 2002.

(8) ProLogis Limited Partnership-IV was formed through a cash contribution from a wholly owned subsidiary of ProLogis, ProLogis IV, Inc., and the contribution of properties from the limited partner. ProLogis Limited Partnership-IV and ProLogis IV, Inc. are legal entities that are separate and distinct from ProLogis, its affiliates and each other, and each has separate assets, liabilities, business functions and operations. At December 31, 2002, the sole asset of ProLogis IV, Inc. was its interest in ProLogis Limited Partnership-IV. At December 31, 2002, ProLogis IV, Inc. had outstanding borrowings from ProLogis of $0.6 million.

(9) These properties are located in the Cincinnati, Dallas/ Ft. Worth, Ft. Lauderdale/ Miami, Houston, I-95 Corridor (New Jersey), Orlando and Tampa markets and one property is located in Akron, Ohio.

(10) This general partnership was formed by another REIT that was merged with and into ProLogis in 1999.

(11) This property is located in the Los Angeles/ Orange County market.

(12) Each unit is convertible into 1.1 Common Shares, plus $2.00.

Unconsolidated Investees

At December 31, 2002, ProLogis investments in and advances to unconsolidated investees (entities that are presented on the equity method rather than consolidated in ProLogis financial statements) totaled $821.4 million. ProLogis investments in and advances to property funds discussed below under Property

Operations totaled $593.5 million at December 31, 2002. ProLogis investments in and advances to the temperature-controlled distribution operating companies totaled $178.4 million at December 31, 2002. ProLogis investment in and advances to the Kingspark Joint Ventures was $45.2 million at December 31, 2002. ProLogis investments in and advances to other companies that do not own real estate totaled $4.3 million at December 31, 2002. ProLogis unconsolidated investees are discussed in Note 4 to ProLogis Consolidated Financial Statements in Item 8. See also Item 1 Business ProLogis Operating Segments.

ProLogis investments in unconsolidated investees, other than the property funds, were structured to allow ProLogis to comply with the REIT requirements under the Code. Certain of these investees produce income that is not REIT qualifying income (i.e., not rental income or mortgage interest income). To maintain its qualification as a REIT, ProLogis can collectively invest in these companies in amounts up to 20% of the fair market value of ProLogis total assets.

With respect to the property funds, an ownership interest of 50% or less is integral to ProLogis business strategy. This business strategy allows ProLogis to realize a portion of the profits from its development activities, earn fees from the property funds, raise private debt and equity capital to fund its future development activities, maintain an ownership interest in its developed properties and maintain relationships with its customers. See Item 1. Business ProLogis Business Strategy.

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Property Operations

At December 31, 2002, ProLogis had ownership interests ranging from 16.1% to 50% in eight property funds that are presented under the equity method. The property funds primarily own operating properties and ProLogis investments in the property funds are included in the property operations segment. The information provided in the table below is for the total entity in which ProLogis has an ownership interest, not ProLogis proportionate share of the entity. ProLogis is the manager of each property fund. See Item 1. Business ProLogis Operating Segments Property Operations Segment and Note 4 to ProLogis Consolidated Financial Statements in Item 8.

	No. of Bldgs.	Rentable Square Footage	Percentage Occupancy(1)	Entity s Investment(2)
North America:				
ProLogis California(3):				
Los Angeles/ Orange County, California	79	13,017,390	92.86%	$620,621,905
ProLogis North American Properties Fund I(4):				
Atlanta, Georgia	5	1,615,688	100.00	53,475,336
Chicago, Illinois	1	249,576	100.00	14,791,711
Cincinnati, Ohio	2	297,720	100.00	15,056,021
Columbus, Ohio	2	888,691	100.00	30,227,733
Dallas/ Ft. Worth, Texas	3	1,221,934	100.00	49,637,817
Denver, Colorado	2	198,892	100.00	9,174,982
El Paso, Texas	1	354,159	100.00	13,613,996
Houston, Texas	2	238,450	100.00	10,854,356
I-95 Corridor, New Jersey	5	1,100,320	79.13	58,983,435
Indianapolis, Indiana	2	719,829	100.00	21,439,503
Louisville, Kentucky	3	905,800	93.38	33,472,045
Nashville, Tennessee	1	412,800	100.00	14,619,970
Phoenix, Arizona	1	156,410	100.00	6,762,008
Salt Lake City, Utah	3	396,600	100.00	17,026,296
San Antonio, Texas	1	244,800	100.00	9,033,242
San Francisco (East Bay), California	2	404,400	91.69	16,956,782
Total ProLogis North American Properties Fund I	36	9,406,069	96.56	375,125,233
ProLogis North American Properties Fund II(5):				
Austin, Texas	4	324,800	100.00	17,823,370
Charlotte, North Carolina	2	178,000	100.00	7,807,320
Chicago, Illinois	4	510,725	72.20	37,848,443
Dallas/ Ft. Worth, Texas	4	669,416	100.00	25,591,595
Denver, Colorado	1	104,400	100.00	5,404,190
El Paso, Texas	1	239,133	100.00	10,315,354
Ft. Lauderdale/ Miami, Florida	3	383,650	100.00	23,611,839
I-81 Corridor, Pennsylvania	1	528,670	100.00	25,418,967
I-95 Corridor, New Jersey	1	501,400	100.00	26,280,972
Reno, Nevada	1	169,625	100.00	7,172,847
San Antonio, Texas	1	160,000	100.00	6,739,827
San Francisco (East Bay), California	1	89,626	100.00	4,345,906
Washington D.C./ Baltimore, Maryland	3	617,225	100.00	35,492,888
Total ProLogis North American Properties Fund II	27	4,476,670	96.83	233,853,518

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	No. of Bldgs.	Rentable Square Footage	Percentage Occupancy(1)	Entity s Investment(2)
ProLogis North American Properties Fund III(5):				
Atlanta, Georgia	2	151,600	78.89	6,825,130
Austin, Texas	6	282,100	86.18	15,486,076
Charlotte, North Carolina	1	136,000	100.00	5,390,350
Cincinnati, Ohio	5	1,044,390	99.97	45,147,881
Columbus, Ohio	1	289,280	100.00	8,561,643
Denver, Colorado	1	104,400	100.00	5,324,759
Houston, Texas	1	140,000	82.86	5,483,341
1-95 Corridor, New Jersey	1	204,000	100.00	10,558,827
Las Vegas, Nevada	1	235,520	100.00	9,872,212
Orlando, Florida	4	361,866	97.22	18,112,612
Portland, Oregon	2	200,600	100.00	10,697,311
San Francisco (East Bay), California	1	351,788	100.00	15,391,381
Seattle, Washington	1	117,620	100.00	5,836,000
St. Louis, Missouri	2	370,000	100.00	14,962,004
Washington D.C./ Baltimore, Maryland	5	391,325	97.35	29,667,790
Total ProLogis North American Properties Fund III	34	4,380,489	97.36	207,317,317
ProLogis North American Properties Fund IV(5):				
Atlanta, Georgia	3	252,800	100.00	13,397,043
Columbus, Ohio	1	1,014,592	100.00	28,001,909
Dallas/ Ft. Worth, Texas	1	180,440	100.00	10,975,768
Denver, Colorado	2	357,400	100.00	15,069,608
El Paso, Texas	1	153,034	100.00	5,716,451
Ft. Lauderdale/ Miami, Florida	1	421,101	100.00	17,206,879
I-95 Corridor, New Jersey	1	181,370	100.00	9,152,342
Phoenix, Arizona	1	273,586	100.00	9,885,012
Portland, Oregon	4	426,780	73.52	24,210,195
San Antonio, Texas	2	213,800	96.26	10,047,100
Total ProLogis North American Properties Fund IV	17	3,474,903	96.52	143,662,307
ProLogis North American Properties Fund V(6):				
United States:				
Atlanta, Georgia	11	1,561,261	100.00	45,467,387
Charlotte, North Carolina	1	246,400	100.00	9,143,973
Chicago, Illinois	1	124,519	100.00	12,015,958
Cincinnati Ohio	2	544,800	81.78	19,289,605
Columbus, Ohio	2	402,439	93.81	13,602,411
Dallas/ Fort Worth, Texas	7	1,597,600	72.33	56,959,465
Denver, Colorado	1	52,915	100.00	1,612,302
El Paso, Texas	2	231,721	100.00	8,388,783
Ft. Lauderdale/ Miami, Florida	2	189,640	79.96	11,091,422
Houston, Texas	1	403,200	100.00	13,368,334
I-81 Corridor, Pennsylvania	1	1,059,645	100.00	49,155,851
I-95 Corridor, New Jersey	1	302,372	100.00	16,001,504

	No. of Bldgs.	Rentable Square Footage	Percentage Occupancy(1)	Entity s Investment(2)
Los Angeles/ Orange County, California	1	670,292	100.00	46,912,645
Louisville, Kentucky	1	350,000	85.71	14,572,946
Nashville, Tennessee	1	214,800	100.00	7,448,839
Portland, Oregon	1	127,420	0.00	6,758,722
Reno, Nevada	2	820,006	100.00	35,053,221
San Antonio, Texas	4	706,308	94.27	26,256,859
San Francisco (East Bay), California	1	401,536	35.02	16,140,419
Washington D.C./ Baltimore, Maryland	1	99,904	100.00	6,354,738
Mexico:				
Monterrey	5	684,940	95.28	36,650,042
Reynosa	4	534,106	100.00	28,503,124
Tijuana	4	653,090	100.00	30,344,101
Total ProLogis North American Properties Fund V	57	11,978,914	90.69	511,092,651
Subtotal North America	250	46,734,435	95.34	2,091,672,931
Europe:				
ProLogis European Properties Fund(7):				
Belgium	2	468,535	100.00	19,928,720
Czech Republic:				
Prague	5	872,239	99.89	56,100,777
France:				
Central	68	10,274,256	88.93	592,701,279
East	2	614,323	100.00	24,884,381
North	7	1,407,317	100.00	58,821,991
South	15	3,675,681	99.99	154,755,919
Germany:				
Rhine/ Mein	1	69,030	100.00	5,076,812
Rhine/ Ruhr	3	623,483	49.65	46,118,346
South	1	210,146	100.00	17,136,844
Hungary:				
Budapest	1	215,280	44.60	11,463,455
Italy:				
Milan	5	1,444,389	47.20	81,934,323
Netherlands:				
Amsterdam	5	804,565	100.00	60,281,485
Rotterdam	9	1,763,121	99.27	94,514,157
South	5	1,553,697	100.00	82,080,059
Poland:				
Central	1	230,629	100.00	14,238,034
South	1	366,877	100.00	23,845,575
Warsaw	9	1,555,246	97.87	116,135,383
West	2	277,701	97.74	15,750,441
Spain:				
Barcelona	7	1,808,771	99.52	119,838,034
Madrid	1	124,755	100.00	8,148,529
Sweden:				
Stockholm	1	216,345	100.00	11,948,416

	No. of Bldgs.	Rentable Square Footage	Percentage Occupancy(1)	Entity s Investment(2)
United Kingdom:				
East Midlands	14	2,917,827	97.26	280,077,381
London and Southeast	12	1,499,207	87.48	238,713,716
North	2	249,047	100.00	22,934,522
West Midlands	14	2,457,932	100.00	281,299,456
Total ProLogis European Properties Fund	193	35,700,399	92.54	2,438,728,035
Asia:				
ProLogis Japan Properties Fund(5):				
Tokyo, Japan	1	198,725	100.00	65,101,127
Total Unconsolidated Investees	**444**	**82,633,559**	**93.45%**	**$4,595,502,093**

(1) The percentage occupancy presented is the physical occupancy at December 31, 2002.

(2) The investment represents 100% of the carrying value of the operating properties of each entity at December 31, 2002.

(3) ProLogis had a 50% ownership interest in ProLogis California at December 31, 2002.

(4) ProLogis had a 41.3% ownership interest in ProLogis North American Properties Fund I at December 31, 2002.

(5) At December 31, 2002, ProLogis had a 20% ownership interest in each of ProLogis North American Properties Fund II, ProLogis North American Properties Fund III, ProLogis North American Properties Fund IV and ProLogis Japan Properties Fund.

(6) ProLogis had a 16.1% ownership interest in ProLogis North American Properties Fund V at December 31, 2002.

(7) ProLogis had a 29.6% ownership interest in ProLogis European Properties Fund at December 31, 2002.

CDFS Business

In the United Kingdom, ProLogis wholly owned subsidiary, Kingspark S.A., has investments in four joint ventures (the Kingspark Joint Ventures) that primarily own and develop distribution properties and own land for the future development of distribution properties. ProLogis ownership in each of the Kingspark Joint Ventures is 50%. One of the Kingspark Joint Ventures owned 11 operating properties that it had previously developed at a total investment of $81.8 million at December 31, 2002. Collectively, the Kingspark Joint Ventures owned 150 acres of land with the capacity for developing approximately 1.5 million square feet of distribution properties at December 31, 2002. Additionally, at December 31, 2002, the Kingspark Joint Ventures collectively controlled 511 acres of land (through contracts, options or letters of intent) with the capacity for developing approximately 9.5 million square feet of distribution properties. See Item 1. Business ProLogis Operating Segments CDFS Business Segment.

Temperature-Controlled Distribution Operations

See Item 1. Business ProLogis Operating Segments Temperature-Controlled Distribution Operations Segment and Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations Results of Operations Temperature-Controlled Distribution Operations for a discussion of the operating assets of the temperature-controlled distribution company in which ProLogis has invested as of December 31, 2002.

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ITEM 3. Legal Proceedings

From time to time, ProLogis and its unconsolidated investees are parties to a variety of legal proceedings arising in the ordinary course of their businesses. Generally, such matters are not expected to have a material adverse effect on ProLogis business, financial position or results of operations.

ITEM 4. Submission of Matters to a Vote of Security Holders

Not applicable.

PART II

ITEM 5. Market for the Registrant s Common Equity and Related Stockholder Matters

ProLogis Common Shares are listed on the NYSE under the symbol PLD . The following table sets forth the high and low sale prices of the Common Shares, as reported in the NYSE Composite Tape, and distributions per Common Share, for the periods indicated.

	High	Low	Per Common Share Distribution
2001:			
First Quarter	$22.937	$19.730	$0.345(1)
Second Quarter	22.950	19.650	0.345
Third Quarter	23.300	19.350	0.345
Fourth Quarter	22.800	19.600	0.345
2002:			
First Quarter	$24.150	$20.960	$0.355(2)
Second Quarter	26.000	21.900	0.355
Third Quarter	25.950	21.700	0.355
Fourth Quarter	25.270	22.850	0.355
2003:			
First Quarter (through March 24)	$ 26.60	$ 23.63	$ 0.36(3)

(1) Declared in the fourth quarter of 2000 and paid in the first quarter of 2001.

(2) Declared in the fourth quarter of 2001 and paid in the first quarter of 2002.

(3) Declared and paid in the first quarter of 2003.

On March 24, 2003, ProLogis had approximately 178,630,570 Common Shares outstanding, which were held of record by approximately 10,500 shareholders.

In 2002, ProLogis Board approved an increase to the maximum amount of Common Shares that ProLogis can repurchase under a Common Share repurchase program from the original maximum of $100.0 million to $215.0 million. Under this program, the Common Shares have been and, to the extent these repurchases continue, they will be repurchased in the open market and in privately negotiated transactions, depending on market prices and other conditions. Common Share repurchases through December 31, 2002 aggregated 5,183,200 Common Shares at a total cost of $121.2 million. As of March 24, 2003, 5,530,800 Common Shares at a total cost of $129.9 million had been repurchased.

In 2002, ProLogis issued 272,000 Common Shares, upon redemption of limited partnership units in one or more of the Partnerships. See Item 2. Properties Properties Real Estate Partnerships. These Common Shares were issued in transactions exempt from registration under Section 4(2) of the Securities Act.

Distributions and Dividends

In order to comply with the REIT requirements under the Code, ProLogis is required to make distributions (other than capital gain distributions) to its shareholders in amounts at least equal to (i) the sum of (a) 90% of its REIT taxable income computed without regard to the dividends paid deduction and its net capital gains and (b) 95% of the net income (after tax), if any, from foreclosure property, minus (ii) the sum of certain items of noncash income. ProLogis distribution policy is to distribute a percentage of its cash flow that ensures that ProLogis will meet the distribution requirements of the Code and allows ProLogis to maximize the cash retained to meet other cash needs such as capital improvements and investment activities.

ProLogis announces the following year s projected annual Common Share distribution level after the annual budget review and approval by the Board in December of each year. In December 2002, the Board announced a projected increase in the annual distribution level for 2003 from $1.42 to $1.44 per Common Share. The payment of distributions is subject to the discretion of the Board and is dependent on the financial condition and operating results of ProLogis. The amount of the distribution may be adjusted at the discretion of the Board during the year. On February 3, 2003, the Board declared a distribution of $0.36 per Common Share for the first quarter of 2003. This distribution was paid on February 28, 2003 to holders of Common Shares on February 14, 2003.

Distributions to shareholders are characterized for federal income tax purposes, as ordinary income, capital gains, non-taxable return of capital or a combination of the three. Distributions that exceed ProLogis current and accumulated earnings and profits (calculated for tax purposes) constitute a return of capital rather than a dividend and reduce the shareholders basis in the Common Shares. To the extent that a distribution exceeds both current and accumulated earnings and profits and the shareholders basis in the Common Shares, it will generally be treated as a gain from the sale or exchange of that shareholder s Common Shares. ProLogis annually notifies shareholders of the taxability of distributions paid during the preceding year. The following summarizes the taxability of distributions on Common Shares for the periods indicated (amounts in U.S. dollars; taxability for 2002 is estimated):

	Years Ended December 31,		
	2002	**2001**	**2000**
Per Common Share:			
Ordinary income	$0.95	$1.09	$1.19
Capital gains	0.06	0.19	0.15
Return of capital	0.41	0.10	
Total	$1.42	$1.38	$1.34

Annual dividends paid on each series of preferred shares were as follows for the periods indicated (in U.S. dollars):

	Years Ended December 31,		
	2002(1)	**2001(2)**	**2000(3)**
Series A Preferred Shares(4)	$	$0.84	$2.35
Series B Convertible Preferred Shares(5)		0.44	1.75
Series C Preferred Shares	4.27	4.27	4.27
Series D Preferred Shares	1.98	1.98	1.98
Series E Preferred Shares	2.19	2.19	2.19

(1) For federal income tax purposes, $4.04 of the Series C dividend, $1.87 of the Series D dividend and $2.07 of the Series E dividend is estimated to represent ordinary income to the holders. The remaining portion of each dividend is estimated to represent capital gains.

(2) For federal income tax purposes $0.71 of the Series A dividend, $0.38 of the Series B dividend, $3.63 of the Series C dividend, $1.68 of the Series D dividend and $1.86 of the Series E dividend represent ordinary income to the holders. The remaining portion of each dividend represents capital gains.

(3) For federal income tax purposes $2.08 of the Series A dividend, $1.55 of the Series B dividend, $3.78 of the Series C dividend, $1.75 of the Series D dividend and $1.94 of the Series E dividend represent ordinary income to the holders. The remaining portion of each dividend represents capital gains.

(4) The Series A Preferred Shares were redeemed as of May 8, 2001.

(5) The Series B Convertible Preferred Shares were redeemed as of March 20, 2001.

Pursuant to the terms of its preferred shares, ProLogis is restricted from declaring or paying any distribution with respect to its Common Shares unless and until all cumulative dividends with respect to the preferred shares have been paid and sufficient funds have been set aside for dividends that have been declared for the then-current dividend period with respect to the preferred shares.

ProLogis tax return for the year ended December 31, 2002 has not been filed. The taxability information for 2002 is based upon the best available data. ProLogis tax returns for previous tax years have not been examined by the Internal Revenue Service. Consequently, the taxability of distributions is subject to change.

Under the Code, ProLogis earnings and profits are first allocated to the preferred shares, which increases the portion of the Common Share distribution that is characterized as return of capital. The portion of distribution that is characterized as return of capital represents the excess of distributions over the earnings and profits, and results because non-cash charges such as depreciation are not considered in determining distribution levels. See Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations Results of Operations.

Common Share Plans

ProLogis holders of Common Shares may acquire additional Common Shares by automatically reinvesting distributions under the 1999 Dividend Reinvestment and Share Purchase Plan (the 1999 Common Share Plan). Holders of Common Shares who do not participate in the 1999 Common Share Plan continue to receive distributions as declared. The 1999 Common Share Plan also allows both holders of Common Shares and persons who are not holders of Common Shares to purchase a limited number of additional Common Shares by making optional cash payments, without payment of any brokerage commission or service charge. Common Shares are acquired pursuant to the 1999 Common Share Plan at a price ranging from 98% to 100% of the market price of such Common Shares. Under the 1999 Common Share Plan, ProLogis generated net proceeds of $125.7 million from the issuance of 5,295,000 Common Shares in 2002. On November 13, 2002, ProLogis amended the 1999 Common Share Plan to: (i) limit participants to only those holders of Common Shares registered on the share transfer books of ProLogis in the shareholders name; (ii) limit the distributions that can be reinvested to those distributions earned on no more than 300,000 Common Shares per quarter; and (iii) allow for the discount from market price at which distributions can be reinvested and optional share purchases can be made to be within a range of 0% to 2% as determined by ProLogis. Previously the discount was fixed at 2%.

Under the terms of the ProLogis Trust Employee Share Purchase Plan (the Employee Share Plan), employees of ProLogis and its participating entities may purchase Common Shares, through payroll deductions only, at a discounted price of 85% of the market price of the Common Shares. Subject to certain provisions, the aggregate number of Common Shares that may be issued under the Employee Share Plan may not exceed 5,000,000. ProLogis began issuing Common Shares under the Employee Share Plan in January 2002. As of December 31, 2002, 22,000 Common Shares have been purchased under the Employee Share Plan generating net proceeds to ProLogis of $0.4 million.

ITEM 6. Selected Financial Data

The following tables set forth selected financial data relating to the historical financial condition and results of operations of ProLogis for 2002 and the four preceding years. Certain amounts for the years prior to 2002 presented in the tables below have been reclassified to conform to the 2002 financial statement presentation. The financial data in the tables is qualified in its entirety by, and should be read in conjunction with, Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations and

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ProLogis Consolidated Financial Statements and related notes in Item 8. The amounts in the table below are in thousands of U.S. dollars, except for per share amounts.

	Years Ended December 31,				
	2002	2001	2000	1999	1998
Operating Data:					
Rental income	$449,479	$466,714	$481,000	$491,826	$345,046
Other real estate income	126,773	99,890	75,573	46,678	17,554
Income (loss) from unconsolidated investees(1)(2)	96,381	(49,644)	78,858	22,519	2,755
Total income(1)(2)	675,001	523,125	643,521	567,392	368,107
Rental expenses, net of recoveries	32,593	28,700	27,177	33,501	27,120
General and administrative expenses	53,893	50,274	44,954	38,284	22,893
Interest expense	152,958	163,629	172,191	170,746	77,650
Earnings from operations(1)(2)	277,941	133,043	241,807	166,549	107,617
Gains on disposition of real estate, net	6,648	10,008	1,314	38,994	5,565
Foreign currency exchange gains (losses), net	(2,031)	(3,721)	(17,927)	(16,818)	2,938
Income tax expense	28,169	4,725	5,130	1,472	2,164
Preferred share dividends	32,715	37,309	56,763	56,835	49,098
Net earnings attributable to Common Shares(1)(2)	216,166	90,835	157,715	123,999	62,231
Common Share cash distributions paid(3)	$252,270	$237,691	$219,333	$208,969	$151,050
Per Share Data:					
Basic net earnings attributable to Common Shares(1)(2)	$ 1.22	$ 0.53	$ 0.96	$ 0.81	$ 0.51
Diluted net earnings attributable to Common Shares	1.20	0.52	0.96	0.81	0.51
Series A Preferred Share dividends paid(4)		0.84	2.35	2.35	2.35
Series B Convertible Preferred Share dividends paid(5)		0.44	1.75	1.75	1.75
Series C Preferred Share dividends paid	4.27	4.27	4.27	4.27	4.27
Series D Preferred Share dividends paid	1.98	1.98	1.98	1.98	1.42
Series E Preferred Share dividends paid(6)	2.19	2.19	2.19	1.64	
Common Share distributions paid(6)	$ 1.42	$ 1.38	$ 1.34	$ 1.30	$ 1.24
Weighted average Common Shares outstanding:					
Basic	177,813	172,755	163,651	152,412	121,721
Diluted	184,869	175,197	164,401	152,739	122,028
Other Data:					
Reconciliation of net earnings to funds from operations(1)(2):					
Net earnings attributable to Common Shares(1)(2)	$216,166	$ 90,835	$157,715	$123,999	$ 62,231
Add (Deduct):					
Real estate related depreciation and amortization	145,233	137,033	146,859	150,050	99,514
Gains on contribution or sale of non-CDFS business segment assets, net	(6,648)	(10,008)	(1,314)	(38,994)	(5,565)

Foreign currency exchange (gains) losses, net	(743)	1,484	19,569	16,596	(3,227)
Deferred income tax expense	17,660	2,258	4,230		1,796
Cumulative effect of accounting change				1,440	
ProLogis share of reconciling items of unconsolidated investees:					
Real estate related depreciation and amortization	41,779	63,948	57,366	49,644	36,489
Write-down of operating assets and other impairment charges(1)	42,917	88,413			

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	Years Ended December 31,				
	2002	2001	2000	1999	1998
(Gains) losses on contribution or sale of non-CDFS business segment assets, net	(2,248)	4,417	(744)	826	179
Foreign currency exchange (gains) losses, net	(4,268)	8,204	(2,773)	14,650	14,208
Deferred income tax expense (benefit)	(13,881)	(12,171)	(4,190)	510	(2,929)
Cumulative effect of accounting change				1,480	
Funds from operations attributable to Common Shares(2)(7)	$ 435,967	$ 374,413	$ 376,718	$ 320,201	$ 202,696
Weighted average Common Shares outstanding:					
Basic	177,813	172,755	163,651	152,412	121,721
Diluted(8)	184,869	180,284	178,166	167,421	137,153
Net cash provided by operating activities	$ 377,235	$ 343,272	$ 321,091	$ 271,376	$ 238,253
Net cash provided by (used in) investing activities	(136,145)	103,952	(376,945)	(34,350)	(1,264,722)
Net cash provided by (used in) financing activities	$(158,270)	$(477,105)	$ 44,386	$(230,828)	$ 1,064,600

	December 31,				
	2002	2001	2000	1999	1998
Financial Position:					
Real estate owned, excluding land held for development, at cost	$5,008,707	$4,387,456	$4,502,087	$4,811,255	$3,476,704
Land held for development	386,820	200,737	187,405	163,696	180,796
Investments in and advances to unconsolidated investees	821,431	1,310,735	1,453,148	940,364	733,863
Total assets	5,923,525	5,559,863	5,946,334	5,848,040	4,330,729
Lines of credit and short-term borrowings(9)	545,906	375,875	439,822	98,700	494,300
Senior unsecured debt	1,630,094	1,670,359	1,699,989	1,729,630	1,083,641
Mortgage notes and other secured debt	555,978	532,106	537,925	695,586	227,804
Total liabilities	2,994,571	2,838,225	2,972,333	2,832,232	2,023,066
Minority interest	42,467	45,639	46,630	62,072	51,295
Total shareholders equity	$2,886,487	$2,675,999	$2,927,371	$2,953,736	$2,256,368
Number of Common Shares outstanding	178,146	175,888	165,287	161,825	123,416

(1) Income (loss) from unconsolidated investees, total income, earnings from operations and net earnings attributable to Common Shares include:

2002: A loss of $42.9 million representing ProLogis proportionate share of the write-downs of operating assets of its unconsolidated investees operating in the temperature-controlled distribution operations segment and net gains of $2.2 million representing ProLogis proportionate share of the net gains of its unconsolidated investees resulting from the sales of certain of their operating assets ($1.5 million of net gains were in the temperature-controlled distribution operations segment).

2001: A loss of $88.4 million representing ProLogis proportionate share of the write-downs of operating assets and other impairment charges of its unconsolidated investees operating in the temperature-controlled distribution operations segment, a loss of $5.8 million representing ProLogis proportionate share of the write-downs of technology related investments of its unconsolidated investees operating in the temperature-controlled distribution operations segment and a net loss of $3.7 million representing ProLogis proportionate share of the net losses of its unconsolidated investees operating in the temperature-controlled distribution operations segment resulting from the sales of

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significant portions of their operating assets. The technology related charges are included in funds from operations attributable to Common Shares.

1999: A one-time expense of $1.4 million related to the write-off of unamortized organization and start-up costs due to an accounting change adopted by ProLogis.

See Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations Results of Operations Temperature-Controlled Distribution Operations.

(2) Income (loss) from unconsolidated investees, total income, earnings from operations, net earnings attributable to Common Shares and funds from operations include:

2001: Losses of $37.0 million representing ProLogis proportionate share of the write-downs of technology related investments of two of ProLogis unconsolidated investees.

1999 and 1998: Losses of $0.9 million and $26.1 million, respectively, of mark to market expense associated with two interest rate hedge agreements that, due to changing market conditions, no longer qualified for hedge accounting treatment under generally accepted accounting principles (GAAP).

See Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations Other Income and Expense Items Income (Loss) from Unconsolidated Investees.

(3) For 1999, includes dividends of $11.1 million that were paid to shareholders of another REIT that was merged with and into ProLogis in March 1999.

(4) The Series A Preferred Shares were redeemed as of May 8, 2001.

(5) The Series B Preferred Shares were redeemed as of March 20, 2001.

(6) For 1999, does not include dividends paid to shareholders of another REIT that was merged with and into ProLogis in March 1999.

(7) ProLogis considers funds from operations to be a useful supplemental measure of comparative period operating performance and as a supplemental measure to provide management, financial analysts, potential investors and shareholders with an indication of ProLogis ability to fund its capital improvements, investment activities and other cash needs. Funds from operations is discussed and defined in Item 7 Management s Discussion and Analysis of Financial Conditions and Results of Operations Funds from Operations. Funds from operations does not represent net earnings or cash from operating activities in accordance with GAAP and is not necessarily indicative of cash available to fund cash needs, which is presented in the Consolidated Statement of Cash Flows in ProLogis Consolidated Financial Statements in Item 8. Cash distributions paid to shareholders are presented above in the Operating Data section of this table. Funds from operations should not be considered as an alternative to net earnings as an indicator of ProLogis operating performance or as an alternative to cash flows from operating, investing or financing activities as a measure of liquidity. Additionally, the funds from operations measure presented by ProLogis will not necessarily be comparable to similarly titled measures of other REITs.

(8) In calculating the weighted average Common Shares for funds from operations purposes, weighted average Series B Convertible Preferred Shares and weighted average limited partnership units are considered potentially dilutive instruments. The weighted average Series B Convertible Preferred Shares included are 1,544,000, 8,417,000, 9,221,000 and 10,055,000 for 2001, 2000, 1999 and 1998, respectively (the Series B Preferred Shares were redeemed in 2001). The amount of dividends associated with the Series B Convertible Preferred Shares are $81,000, $11,358,000, $12,523,000 and $13,668,000 and for 2001, 2000, 1999 and 1998, respectively (the Series B Preferred Shares were redeemed in 2001). The weighted average limited partnership units included are 4,938,000, 5,087,000, 5,348,000, 5,461,000 and 5,070,000 for 2002, 2001, 2000, 1999 and 1998, respectively. The minority interest share in earnings associated with these limited partnership units are $5,508,000, $5,968,000, $5,586,000, $4,979,000 and $4,681,000 for 2002, 2001, 2000, 1999 and 1998, respectively.

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(9) At March 24, 2003, ProLogis had $520.1 million of total borrowings outstanding under its revolving credit agreements resulting in $606.9 million of borrowing capacity available (total commitment of $1.15 billion reduced by $21.2 million of letters of credit outstanding with lending banks at March 24, 2003).

ITEM 7. Management s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with ProLogis Consolidated Financial Statements and the related notes included in Item 8 of this report.

Some statements contained in this discussion are not historical facts but are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Because these forward-looking statements are based on current expectations, estimates and projections about the industry and markets in which ProLogis operates, management s beliefs and assumptions made by management, they involve uncertainties that could significantly impact ProLogis financial results. Words such as expects , anticipates , intends , plans , believes , seeks estimates , variations of such words and similar expressions are intended to identify such forward-looking statements. Forward-looking statements include discussions of strategy, plans or intentions of management. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to predict. The discussions concerning ProLogis expectations with respect to economic conditions in the United States, its ability to raise private capital and generate income in the CDFS business segment (including the discussions with respect to ProLogis expectations as to the availability of capital in ProLogis European Properties Fund and ProLogis North American Properties Fund V such that these property funds will be able to acquire ProLogis stabilized developed properties that are expected to be available for contribution during 2003) and its plans for its investments in the temperature-controlled distribution operations segment contain forward-looking statements. Therefore, actual outcomes and results may differ materially from what is expressed or forecasted in such forward-looking statements. Factors that may affect outcomes and results include: (i) changes in general economic conditions in ProLogis markets that could adversely affect demand for ProLogis properties and the creditworthiness of ProLogis customers; (ii) changes in financial markets, interest rates and foreign currency exchange rates that could adversely affect ProLogis cost of capital, its ability to meet its financial needs and obligations and its results of operations; (iii) increased or unanticipated competition for distribution properties in ProLogis markets; (iv) the availability of private capital to ProLogis; (v) geopolitical concerns and uncertainties resulting because the United States is at war with Iraq; and (vi) those additional factors discussed under Risk Factors.

Critical Accounting Policies

A critical accounting policy is one that is both important to the portrayal of an entity s financial condition and results of operations and requires judgment on the part of management. Generally, the judgment requires management to make estimates about the effect of matters that are inherently uncertain. Of the accounting policies discussed in Note 2 to ProLogis Consolidated Financial Statements in Item 8, those presented below have been identified by ProLogis as critical accounting policies.

Consolidation

ProLogis consolidated financial statements include the accounts of ProLogis, its wholly owned subsidiaries and its majority-owned and controlled subsidiaries and partnerships. All subsidiaries in which ProLogis owns a majority voting interest are consolidated. Investments in entities in which ProLogis does not own a majority voting interest but does have the ability to exercise significant influence over operating and financial policies are presented under the equity method. Investments in entities in which ProLogis does not own a majority voting interest and over which ProLogis does not have the ability to exercise significant influence are carried at the lower of cost or fair value, as appropriate. Management s judgments with respect to its level of influence or control of each entity involves consideration of various factors including the form of ProLogis ownership interest, its representation on the board of directors, the size of its investment (including loans) and ProLogis ability to participate in policy making decisions. Management s ability to correctly assess its influence or control over an entity affects the presentation of these investments in ProLogis financial statements and, consequently, its financial position and specific items in its results of operations which are used by its shareholders, potential investors, industry analysts and lenders to evaluate ProLogis.

Impairment of Long-Lived Assets

ProLogis and its unconsolidated investees assess the carrying value of their respective long-lived assets whenever events or changes in circumstances indicate that the carrying value of these assets may not be recoverable and, with respect to goodwill, at least annually using a fair-value-based test. The determination of the fair value of long-lived assets, including goodwill, involves significant judgment. This judgment is based on management s analysis and estimates of the future operating results and resulting cash flows of each long-lived asset. Management s ability to accurately predict future operating results and cash flows impacts the determination of fair value.

If there is a decline in fair value of a long-lived asset combined with a history of operating losses for the asset, ProLogis or its unconsolidated investees will be required to determine whether the losses associated with the asset will continue. Management s assessment as to the nature of a decline in fair value is primarily based on estimates of future operating results, the resulting cash flows and ProLogis intent to either hold or dispose of the long-lived asset. If an investment is considered impaired, a write-down is recognized.

Revenue Recognition

ProLogis recognizes gains from the contributions and sales of real estate assets generally at the time the title to the asset is transferred and ProLogis has no future involvement with the asset sold. In certain transactions, an entity in which ProLogis has an ownership interest will acquire the real estate assets from ProLogis. Management makes judgments based on the specific terms of each transaction as to the amount of the total profit from the transaction that ProLogis can recognize given its ownership interests and its level of future involvement in these investees that are acquiring the assets. Management s ability to accurately assess the provisions of each disposition transaction under the accounting guidelines for profit recognition could impact ProLogis financial position and results of operations which are used by shareholders, potential investors, industry analysts and lenders to evaluate ProLogis.

Depreciation and Useful Lives of Real Estate Assets

ProLogis estimates the depreciable portion of its real estate assets and the related useful lives in order to record depreciation expense related to these assets. Management s ability to accurately estimate the depreciable portion of its real estate assets and their useful lives is critical to the determination of the appropriate amount of depreciation expense recorded and the carrying value of the underlying assets. Any change to the estimated depreciable lives of these assets used by ProLogis would have an impact on the depreciation expense recognized by ProLogis.

Recently Issued Accounting Standards

ProLogis adopted the following recently issued accounting standards as of January 1, 2003. Adoption of these standards has not had a material impact on ProLogis financial position, results of operations or cash flows:

Statement of Financial Accounting Standards (SFAS) No. 145, Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB statement No. 13, and Technical Corrections. SFAS No. 145 significantly limits the treatment of losses associated with early extinguishment of debt as an extraordinary item and impacts certain sale-leaseback transactions.

SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities. SFAS No. 146 requires that certain expenses associated with restructuring charges be accrued as liabilities in the period in which the liability is incurred.

SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure, an amendment of FASB Statement No. 123. ProLogis does not account for share-based compensation under the fair value method provided in SFAS No. 123.

In January 2003, Interpretation No. 46, Consolidation of Variable Interest Entities , was issued. ProLogis is required to adopt the requirements of this interpretation for its consolidated financial statements for the fiscal year or interim period beginning after June 15, 2003. This interpretation clarifies the application of Accounting Research Bulletin No. 51, Consolidated Financial Statements , and requires that ProLogis present any variable interest entities in which it has a majority variable interest on a consolidated basis in its financial statements. Based on its initial assessment, ProLogis believes that it will begin to consolidate Frigoscandia S.A. and CSI/ Frigo LLC in its financial statements beginning with the consolidated condensed financial statements issued for the quarterly period ended September 30, 2003. Currently, ProLogis presents its investments in Frigoscandia S.A. and CSI/ Frigo LLC, which operate in the temperature-controlled distributions segment, on the equity method. ProLogis combined effective ownership in these entities was 99.75% at December 31, 2002. See Temperature Controlled Distribution Operations.

In November 2002, Interpretation No. 45, Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness to Others as an interpretation of SFAS Nos. 5, 57 and 107 and a rescission of Interpretation No. 34 was issued. This interpretation elaborates on the existing disclosure requirements for most guarantees, including loan guarantees such as standby letters of credit and provides that an entity that issues a guarantee must recognize an initial liability for the fair value, or market value, of the obligations it assumes under that guarantee. Further, this interpretation requires that this information be disclosed in the interim and annual financial statements. The initial recognition and measurement provisions of this interpretation are applicable to guarantees issued or modified after December 31, 2002. ProLogis does not believe that the application of this interpretation will have a material effect on its financial position, results of operations or cash flows. The disclosure requirements in the interpretation were effective immediately and ProLogis has made all applicable disclosures in the notes to its Consolidated Financial Statements for 2002.

Results of Operations

ProLogis net earnings attributable to Common Shares were $216.2 million in 2002, $90.8 million in 2001 and $157.7 million in 2000. Basic and diluted per share net earnings attributable to Common Shares were $1.22 and $1.20 per share, respectively, in 2002 and $0.53 and $0.52 per share, respectively, in 2001. Basic and diluted net earnings attributable to Common Shares were $0.96 per share in 2000.

The temperature-controlled distribution operating segment was the primary source of ProLogis increase in net earnings in 2002 from 2001. Under the equity method, ProLogis proportionate share of the earnings or losses of its two unconsolidated investees operating in this segment was income of $7.1 million in 2002, a loss of $111.5 million in 2001 and a loss of $8.3 million in 2000. The loss in 2000 is primarily attributable to poor operating performance. In 2001, the operating performance of these companies did not improve and ProLogis proportionate share of these companies combined net losses from the sales of significant portions of their operating assets and related impairment charges was $97.9 million. In 2002, the operating performance of these companies improved over 2001 levels, in part due to depreciation not being recognized on assets held for sale. Also in 2002, ProLogis proportionate share of these companies combined net gains from the dispositions of significant portions of their assets and related impairment charges was $41.4 million.

In 1999, ProLogis shifted the primary focus of its development activities to the development of properties that ProLogis intends to contribute to property funds or sell to third parties. Consequently, the CDFS business segment s role in ProLogis business strategy increased. The CDFS business segment provides capital to fund ProLogis development activities and generates profits that have contributed to ProLogis net earnings. ProLogis earnings from operations from this segment were constant in 2002 ($152.3 million as compared to $151.7 million in 2001) after increasing by $37.2 million in 2001 over 2000 and increasing by $48.9 million in 2000 over 1999. The increases in 2000 and 2001 were primarily the result of the volume of properties contributed to property funds by ProLogis. ProLogis property operations segment s earnings from operations

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was also constant in 2002 ($477.6 million in 2002 as compared to $477.5 million in 2001) after decreasing by $16.4 million in 2001 from 2000. This operating segment s earnings from operations includes rental income and net rental expenses from properties directly owned by ProLogis and also ProLogis proportionate share of the earnings or losses of the property funds and fees earned for services provided to the property funds. See Property Operations , CDFS Business and Temperature-Controlled Distribution Operations.

ProLogis adopted Statement of Financial Accounting Standards (SFAS) No. 142, Goodwill and Other Intangible Assets on January 1, 2002. Accordingly, ProLogis and its unconsolidated investees did not recognize amortization expense related to goodwill during 2002. See Note 2 to ProLogis Consolidated Financial Statements in Item 8. Had the accounting provisions for goodwill not changed in 2002, ProLogis estimates that it would have recognized amortization expense of $6.8 million directly and has also estimated that its aggregate proportionate share of the amortization expense that would have been recognized by its unconsolidated investees in 2002 to be $4.8 million.

Property Operations

In addition to its directly owned operating properties, ProLogis includes its investments in property funds that are presented under the equity method in its property operations segment. See Note 4 to ProLogis Consolidated Financial Statements in Item 8. ProLogis owned or had ownership interests through the property funds in the following operating properties as of the dates indicated (square feet in thousands):

	December 31,					
	2002		2001		2000	
	Number	Square Footage	Number	Square Footage	Number	Square Footage
Direct ownership(1)	1,230	127,956	1,208	123,356	1,244	126,275
Property Funds:						
ProLogis California(2)	79	13,017	79	13,052	77	12,395
ProLogis North American Properties Fund I(1)(3)	36	9,406	36	8,963	33	8,031
ProLogis North American Properties Fund II(1)(4)	27	4,477	27	4,477	3	440
ProLogis North American Properties Fund III(1)(5)	34	4,380	34	4,380		
ProLogis North American Properties Fund IV(1)(6)	17	3,475	17	3,475		
ProLogis North American Properties Fund V(1)(7)	57	11,979				
ProLogis European Properties Fund and ProLogis European Properties S.a.r.l.(8)	193	35,700	141	23,130	104	14,385
ProLogis Japan Properties Fund(9)	1	199				
Subtotal property funds	444	82,633	334	57,477	217	35,251
Totals	1,674	210,589	1,542	180,833	1,461	161,526

(1) Includes operating properties directly owned by ProLogis. See Item 2. Properties Properties and Item 2. Properties Real Estate Partnerships.

ProLogis contributes properties to property funds and sells properties to third parties as part of its business strategy. ProLogis reflects the properties that it intends to hold for long-term investment, as well as properties that were developed with the intent to contribute the property to a property fund or sell the property to a third party or properties that were acquired with the intent to contribute the property to a property fund, including properties that are being or have been rehabilitated and/or repositioned in the

CDFS business segment but that have not yet been contributed or sold in the property operations segment. Consequently, the size of this portfolio will fluctuate from period to period. Also, ProLogis will, as necessary, contribute operating properties originally intended for long-term investment to a property fund in order to meet the leasing, geographic and size requirements of a property fund s third party investors. The increase in properties directly owned in 2002 from 2001 is partially due to the poor economic conditions in the United States during 2002. Leasing activity slowed in 2002, delaying contributions to property funds since the properties that are contributed to property funds generally must meet certain leasing criteria. Also, ProLogis has used the proceeds received from the dispositions of operating assets from the temperature-controlled distribution operations segment to acquire properties that it intends to rehabilitate and/or reposition prior to contributing or selling the properties, thus increasing the size of this portfolio at December 31, 2002.

(2) ProLogis has had a 50% ownership interest in ProLogis California since it began operations on August 26, 1999.

(3) ProLogis had a 41.3% ownership interest at both December 31, 2002 and 2001 and had an ownership interest of 20% at December 31, 2000. This property fund began operations on June 30, 2000 with the acquisition of 33 operating properties from ProLogis. In January 2001, ProLogis contributed three additional operating properties to this property fund and received all of the $34.1 million of proceeds in an additional equity interest in the property fund. This transaction increased ProLogis ownership interest to 41.3% as of January 15, 2001.

(4) ProLogis has had a 20% ownership interest in ProLogis North American Properties Fund II since it began operations on June 30, 2000. This property fund originally acquired three operating properties from ProLogis in 2000 and acquired 24 additional operating properties from ProLogis in 2001.

(5) ProLogis has had a 20% ownership interest in ProLogis North American Properties Fund III since it began operations on June 15, 2001. This property fund s 34 operating properties were all acquired from ProLogis in 2001.

(6) ProLogis has had a 20% ownership interest in ProLogis North American Properties Fund IV since it began operations on September 21, 2001. This property fund s 17 operating properties were all acquired from ProLogis in 2001.

(7) ProLogis had a 16.1% ownership interest in ProLogis North American Properties Fund V at December 31, 2002. ProLogis ownership interest in this property fund has been between 15.0% and 16.7% since it began operations on March 28, 2002. This property fund s 57 operating properties were all acquired from ProLogis in 2002.

(8) ProLogis ownership interest in ProLogis European Properties Fund was 29.6%, 35.4% and 34.4% at December 31, 2002, 2001 and 2000, respectively. This property fund began operations on September 23, 1999. The operating properties at December 31, 2000, include 44 operating properties aggregating 7,751,000 square feet that were owned directly by the property fund and 60 operating properties aggregating 6,634,000 square feet that were owned by ProLogis European Properties S.a.r.l. ProLogis European Properties S.a.r.l was 100% owned by ProLogis until January 7, 2000 when ProLogis contributed 50.1% of this entity to the property fund in exchange for an additional equity interest in the property fund. ProLogis contributed the remaining 49.9% of ProLogis European Properties S.a.r.l. to the property fund on January 7, 2001.

(9) ProLogis has had a 20% ownership interest in ProLogis Japan Properties Fund since it began operations on September 24, 2002. ProLogis developed the property owned by this property fund.

The earnings from operations of ProLogis property operations segment consists of: (i) net operating income (rental income less net rental expenses) from the operating properties that are directly owned by ProLogis; (ii) income recognized by ProLogis under the equity method from its investments in the property funds; and (iii) fees earned by ProLogis for services performed on behalf of the property funds, primarily property management and asset management services. The net operating income generated by operating properties that were developed by ProLogis with the intent to contribute the property to a property fund or sell the property to a third party or properties that were acquired by ProLogis with the intent to contribute the

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property to a property fund, including those properties that are being or have been rehabilitated and/or repositioned in the CDFS business segment, is included in the property operations segment during the period that these properties are included in the property operations segment (generally from the date of acquisition or date of completion of development, rehabilitation or repositioning activities through the date the properties are contributed to a property fund or sold to a third party). See Item 1. Business Business Strategy and Operating Segments Property Operations Segment , Item 1. Business Business Strategy and Operating Segments CDFS Business Segments and Note 10 to ProLogis Consolidated Financial Statements in Item 8.

The amounts recognized under the equity method represent ProLogis share of the earnings or losses of each property fund based on its ownership interest and include the following income and expense items, in addition to net operating income: (i) interest income and interest expense; (ii) depreciation and amortization expenses; (iii) general and administrative expenses; (iv) income taxes; and (v) foreign currency exchange gains and losses, with respect to ProLogis European Properties Fund. See Note 10 to ProLogis Consolidated Financial Statements in Item 8. The number of properties in each property fund and ProLogis ownership percentage as of December 31, 2002, 2001 and 2000 are presented above. ProLogis earnings from operations from the property operations segment were follows for the periods indicated (in thousands of U.S. dollars).

	Years Ended December 31,		
	2002	2001	2000
Properties directly owned by ProLogis:			
Rental income(1)(2)	$449,479	$466,714	$481,000
Rental expenses, net of recoveries from customers(2)(3)	32,593	28,700	27,177
Net operating income	416,886	438,014	453,823
Property funds:			
Income from ProLogis California	14,379	13,147	13,178
Income from ProLogis North American Properties Fund I(4)	5,997	4,648	1,806
Income from ProLogis North American Properties Fund II(4)	3,645	2,328	612
Income from ProLogis North American Properties Fund III(5)	2,779	1,178	
Income from ProLogis North American Properties Fund IV(6)	1,977	598	
Income from ProLogis North American Properties Fund V(7)	7,544		
Income from ProLogis European Properties Fund(8)	24,162	17,581	24,484
Income from ProLogis Japan Properties Fund(9)	239		
Subtotal property funds	60,722	39,480	40,080
Total property operations segment	$477,608	$477,494	$493,903

(1) The number and composition of operating properties in the directly owned portfolio throughout the periods presented impact rental income for each period. Rental income in 2002 includes $14.6 million of termination and renegotiation fees as compared to comparable fees recognized in 2001 of $3.1 million and in 2000 of $3.2 million. In certain leasing situations, ProLogis finds it advantageous to have its customers exercise termination clauses in their leases; however, ProLogis cannot predict the levels of such fees that will be earned in the future or whether ProLogis will be successful in re-leasing the vacant space associated with the lease terminations in a timely manner. Rental income, excluding termination and renegotiation fees, decreased by $28.7 million in 2002 from 2001, primarily due to lower average occupancy levels in 2002 as compared to 2001. Overall occupancy declines were experienced in all regions of the United States and in Europe. Rental income, excluding termination and renegotiation fees decreased by $14.2 million in 2001 from 2000, primarily due to the decrease in the number of operating properties directly owned during the period and, to a lesser extent, deceases in average occupancy levels.

(2) Rental expenses, before recoveries, were 28.0% of rental income in 2002 as compared to 26.7% of rental income in 2001 and 24.7% of rental income in 2000. Total rental expense recoveries were 74.0%, 76.9% and 77.1% of total rental expenses in 2002, 2001 and 2000, respectively.

(3) The number and composition of operating properties in the directly owned portfolio throughout the periods presented impacts rental expenses for each period. The increase in net rental expenses in 2002 is primarily due to the lower occupancy levels experienced in 2002. Lower occupancy levels result in certain fixed costs being incurred directly by ProLogis, as there are fewer customers to pay them. Additionally, a higher percentage of common area costs were absorbed by ProLogis in 2002, as there are fewer customers available from whom these costs can be recovered. The economic weaknesses that began in the United States in late 2001 contributed to the increase in operating costs in 2001 over 2000, as did the nature and composition of operating properties in the directly owned portfolio in each period.

(4) ProLogis North American Properties Fund I and ProLogis North American Properties Fund II began operations on June 30, 2000.

(5) ProLogis North American Properties Fund III began operations on June 15, 2001.

(6) ProLogis North American Properties Fund IV began operations on September 21, 2001.

(7) ProLogis North American Properties Fund V began operations on March 28, 2002.

(8) Includes net foreign currency exchange losses of $4.5 million in 2002, net foreign currency exchange gains of $0.8 million in 2001 and net foreign currency exchange gains of $4.7 million in 2000. Excluding these net foreign currency exchange gains and losses, ProLogis proportionate share of the earnings of ProLogis European Properties Fund is $28.7 million, $16.8 million and $19.8 million for 2002, 2001 and 2000, respectively. The increase in the income recognized by ProLogis from its ownership in this property fund, excluding foreign currency losses in 2002, is primarily the result of: (i) the additional properties owned in 2002 as compared to 2001; (ii) increases in the fees earned by ProLogis for services provided to the property fund due to the increase in properties owned; offset by