

Edgar Filing: CARRAMERICA REALTY CORP - Form 10-Q

CARRAMERICA REALTY CORP  
Form 10-Q  
August 14, 2002

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

FOR QUARTER ENDED June 30, 2002

COMMISSION FILE NO. 1-11706

CARRAMERICA REALTY CORPORATION

(Exact name of registrant as specified in its charter)

Maryland 52-1796339  
(State or other jurisdiction of (I.R.S. Employer Identification Number)  
incorporation or organization)

1850 K Street, N.W., Washington, D.C. 20006  
(Address or principal executive office) (Zip code)

Registrant's telephone number, including area code (202) 729-1700

N/A  
(Former name, former address and former fiscal year, if changed since last  
report)

Number of shares outstanding of each of the registrant's  
classes of common stock, as of August 5, 2002:

Common Stock, par value \$.01 per share: 53,120,091 shares

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 twelve (12) months (or such shorter period that the Registrant was  
required to file such reports) and (2) has been subject to such filing  
requirements for the past ninety (90) days.

YES [X] NO[ ]

Index

Part I: Financial Information

Item 1. Financial Statements

Consolidated balance sheets of CarrAmerica Realty Corporation and subsidiaries as

## Edgar Filing: CARRAMERICA REALTY CORP - Form 10-Q

	of June 30, 2002 (unaudited) and December 31, 2001.....
	Consolidated statements of operations of CarrAmerica Realty Corporation and subsidiaries for the three and six months ended June 30, 2002 and 2001 (unaudited).
	Consolidated statements of cash flows of CarrAmerica Realty Corporation and subsidiaries for the six months ended June 30, 2002 and 2001 (unaudited).....
	Notes to consolidated financial statements (unaudited).....
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations.....
Item 3.	Quantitative and Qualitative Disclosures About Market Risk.....
Part II: Other Information	
Item 4.	Submission of Matters to a Vote of Security Holders.....
Item 6.	Exhibits and Reports on Form 8-K.....

2

### Part I

#### Item 1. Financial Information

The information furnished in our accompanying consolidated balance sheets, consolidated statements of operations and consolidated statements of cash flows reflects all adjustments which are, in our opinion, necessary for a fair presentation of the aforementioned financial statements for the interim periods.

The financial statements should be read in conjunction with the notes to the financial statements and Management's Discussion and Analysis of Financial Condition and Results of Operations. The results of operations for the three and six months ended June 30, 2002 are not necessarily indicative of the operating results to be expected for the full year.

3

#### CARRAMERICA REALTY CORPORATION AND SUBSIDIARIES Consolidated Balance Sheets As of June 30, 2002 and December 31, 2001

	June 30, 2002	December 31, 2001
	-----	-----
	(unaudited)	
(In thousands, except share amounts)		
Assets		
Rental property:		
Land	\$ 654,278	\$ 647,747
Buildings	1,875,922	1,857,775
Tenant improvements	373,338	362,736
Furniture, fixtures and equipment	3,810	3,789

Edgar Filing: CARRAMERICA REALTY CORP - Form 10-Q

	-----	-----
	2,907,348	2,872,047
Less: Accumulated depreciation	(529,311)	(477,694)
	-----	-----
Total rental property	2,378,037	2,394,353
Land held for development or sale	45,082	45,195
Construction in progress	12,005	19,324
Cash and cash equivalents	4,547	5,041
Restricted deposits	3,766	4,596
Accounts and notes receivable, net	19,028	28,551
Investments in unconsolidated entities	120,974	118,479
Accrued straight-line rents	71,822	66,781
Tenant leasing costs, net	50,061	53,894
Deferred financing costs, net	2,947	2,640
Prepaid expenses and other assets, net	32,033	30,688
	-----	-----
	\$2,740,302	\$2,769,542
	=====	=====
Liabilities, Minority Interest, and Stockholders' Equity		
Liabilities:		
Mortgages and notes payable, net	\$1,391,194	\$1,399,230
Accounts payable and accrued expenses	91,337	76,786
Rents received in advance and security deposits	26,470	32,326
	-----	-----
Total liabilities	1,509,001	1,508,342
Minority interest	80,622	83,393
Stockholders' equity:		
Preferred stock, \$.01 par value, authorized 35,000,000 shares:		
Series A Cumulative Convertible Redeemable Preferred Stock, 80,000 shares issued and outstanding at December 31, 2001 with an aggregate liquidation preference of \$2,000	--	1
Series B, C, and D Cumulative Redeemable Preferred Stock, 8,217,120 and 8,800,000 shares issued and outstanding with an aggregate liquidation preference of \$379,526 and \$400,000 at June 30, 2002 and December 31, 2001, respectively	82	88
Common stock, \$.01 par value, authorized 180,000,000 shares issued and outstanding 53,116,238 shares at June 30, 2002 and 51,965,066 shares at December 31, 2001	531	520
Additional paid-in capital	1,361,907	1,356,912
Cumulative dividends in excess of net income	(211,841)	(179,714)
	-----	-----
Total stockholders' equity	1,150,679	1,177,807
	-----	-----
Commitments and contingencies	\$2,740,302	\$2,769,542
	=====	=====

See accompanying notes to consolidated financial statements.

Edgar Filing: CARRAMERICA REALTY CORP - Form 10-Q

	Three Months Ended June 30,		Six Months June
	2002	2001	2002
Operating revenues:			
Rental revenue:			
Base rent	\$107,935	\$105,802	\$216,178
Recoveries from tenants	13,573	14,683	29,741
Parking and other tenant charges	2,511	3,338	5,304
Total rental revenue	124,019	123,823	251,223
Real estate service revenue	5,488	9,703	11,615
Total operating revenues	129,507	133,526	262,838
Operating expenses:			
Property expenses:			
Operating expenses	29,574	28,433	60,448
Real estate taxes	11,297	10,050	23,030
Interest expense	24,442	21,136	48,830
General and administrative	8,077	11,718	19,118
Depreciation and amortization	31,487	30,820	65,603
Total operating expenses	104,877	102,157	217,029
Real estate operating income	24,630	31,369	45,809
Other (expense) income:			
Interest income	216	1,023	410
Obligations under lease guarantees	(6,293)	--	(8,693)
Equity in earnings of unconsolidated entities	2,202	3,674	4,245
Total other (expense) income	(3,875)	4,697	(4,038)
Income before income taxes, minority interest, and gain (loss) on sale of assets and other provisions, net	20,755	36,066	41,771
Income taxes	(61)	(408)	(94)
Minority interest	(3,384)	(3,076)	(6,007)
Gain (loss) on sale of assets and other provisions, net	2,875	(22)	2,015
Net income	\$ 20,185	\$ 32,560	\$ 37,685
Basic net income per common share	\$ 0.22	\$ 0.39	\$ 0.39
Diluted net income per common share	\$ 0.21	\$ 0.38	\$ 0.38

See accompanying notes to consolidated financial statements.

Edgar Filing: CARRAMERICA REALTY CORP - Form 10-Q

(Unaudited and in thousands)

	2002	2001
	-----	-----
Cash flows from operating activities:		
Net income	\$ 37,685	\$ 62,8
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	65,603	61,6
Minority interest	6,007	4,5
Equity in earnings of unconsolidated entities	(4,245)	(7,0
Gain on sale of assets and other provisions, net	(2,015)	(1,0
Obligations under lease guarantees	8,693	
Provision for uncollectible accounts	3,071	4,7
Stock-based compensation	2,262	1,4
Other	796	2
Changes in assets and liabilities:		
Decrease in accounts receivable	6,664	16,1
Increase in accrued straight-line rents	(5,132)	(5,4
Additions to tenant leasing costs	(5,497)	(5,5
Increase in prepaid expenses and other assets	(2,399)	(7,8
Increase (decrease) in accounts payable and accrued expenses	5,132	(32,2
(Decrease) increase in rent received in advance and security deposits	(5,856)	1,2
Total adjustments	73,084	30,9
Net cash provided by operating activities	110,769	93,7
	-----	-----
Cash flows from investing activities:		
Acquisition and development of rental property	(34,598)	(16,2
Additions to land held for development or sale	(1,205)	(34,8
Additions to construction in progress	(2,581)	(19,2
Payments on notes receivable	--	16,5
Distributions from unconsolidated entities	5,490	89,6
Investments in unconsolidated entities	(4,065)	(10,4
Acquisition of minority interest	(3,371)	(3,2
Decrease in restricted deposits	830	32,1
Proceeds from sales of properties	10,699	100,4
Net cash (used by) provided by investing activities	(28,801)	154,8
	-----	-----
Cash flows from financing activities:		
Repurchase of common stock	--	(119,2
Repurchase of preferred stock	(20,672)	
Exercises of stock options	24,960	16,0
Proceeds from issuance of unsecured notes	394,496	
Net repayments on unsecured credit facility	(369,000)	(86,0
Deferred financing costs	(689)	
Proceeds from mortgages	--	26,6
Repayments of mortgages payable	(36,334)	(15,5
Dividends and distributions to minority interests	(75,223)	(80,8
Net cash used by financing activities	(82,462)	(258,8
	-----	-----
Decrease in cash and cash equivalents	(494)	(10,2
Cash and cash equivalents, beginning of the period	5,041	24,7
	-----	-----
Cash and cash equivalents, end of the period	\$ 4,547	\$ 14,4
	=====	=====

## Edgar Filing: CARRAMERICA REALTY CORP - Form 10-Q

Supplemental disclosure of cash flow information:

Cash paid for interest (net of capitalized interest of \$1,905 and \$3,837 for the six months ended June 30, 2002 and 2001, respectively)	\$ 35,845	\$ 49,2
	=====	=====
Cash paid for income taxes	\$ 460	\$ 25,6
	=====	=====

See accompanying notes to consolidated financial statements.

6

CARRAMERICA REALTY CORPORATION AND SUBSIDIARIES  
Notes to Consolidated Financial Statements  
(Unaudited)

---

(1) Description of Business and Summary of Significant Accounting Policies

(a) Business

We are a fully integrated, self-administered and self-managed publicly traded real estate investment trust ("REIT"), organized as a corporation under the laws of Maryland. We focus on the acquisition, development, ownership and operation of office properties, located primarily in selected suburban markets across the United States.

(b) Basis of Presentation

Our accounts and those of our majority-owned/controlled subsidiaries and affiliates are consolidated in the financial statements. We use the equity or cost methods, as appropriate in the circumstances, to account for our investments in and our share of the earnings or losses of unconsolidated entities. These entities are not majority owned or controlled by us.

Management has made a number of estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses in the financial statements, and the disclosure of contingent assets and liabilities. Estimates are required in order for us to prepare our financial statements in conformity with accounting principles generally accepted in the United States of America. Significant estimates are required in a number of areas, including the evaluation of impairment of long-lived assets and equity and cost method investments and evaluation of the collectibility of accounts and notes receivable. Actual results could differ from these estimates.

(c) Interim Financial Statements

The financial statements reflect all adjustments, which are, in our opinion, necessary to reflect a fair presentation of the results for the interim periods, and all adjustments are of a normal, recurring nature.

(d) New Accounting Pronouncements

In June 2001, the FASB issued SFAS No. 141, "Business Combinations" and SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 141 requires that the purchase method of accounting be used for all business combinations initiated after June 2001. SFAS No. 142 changes

## Edgar Filing: CARRAMERICA REALTY CORP - Form 10-Q

the accounting for goodwill and intangible assets with indefinite useful lives from an amortization approach to an impairment-only approach. Adoption of SFAS No. 142 in January 2002 did not have a material effect on our financial statements.

In October 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS No. 144 supersedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of," and APB Opinion No. 30, "Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions." The Statement does not change the fundamental provisions of SFAS No. 121; however, it resolves various implementation issues of SFAS No. 121 and establishes a single accounting model for long-lived assets to be disposed of by sale. It retains the requirement of Opinion No. 30 to report separately discontinued operations but extends that reporting to a component of an entity that either has been disposed of (by sale, abandonment, or in distribution to owners) or is classified as held for sale. Adoption of SFAS No. 144 in January 2002 did not have a material effect on our financial statements. However, in the event we sell properties in the future where we have limited or no continuing involvement with the property after such sale we would be required to reclassify portions of previously reported earnings to discontinued operations. We are also required to present assets held for sale and the related liabilities separately in our consolidated balance sheets if we meet the applicable criteria of SFAS No. 144.

7

CARRAMERICA REALTY CORPORATION AND SUBSIDIARIES  
 Note to Consolidated Financial Statement  
 (Unaudited)

(e) Earnings Per Share

The following table sets forth information relating to the computations of our basic and diluted earnings per share:

(In thousands, except per share amounts)	Three Months Ended June 30, 2002			Income (Numerator)
	Income (Numerator)	Shares (Denominator)	Per Share Amount	Income (Numerator)
Basic EPS	\$11,668	53,015	\$0.22 =====	\$23,815
Effect of Dilutive Securities Stock options	--	1,301		--
Diluted EPS	\$11,668 =====	54,316 =====	\$0.21 =====	\$23,815 =====

Six Months Ended

Edgar Filing: CARRAMERICA REALTY CORP - Form 10-Q

(In thousands, except per share amounts)	June 30, 2002			
	Income (Numerator)	Shares (Denominator)	Per Share Amount	Income (Numerator)
Basic EPS	\$20,620	52,672	\$0.39	\$45,432
Effect of Dilutive Securities			=====	
Stock options	--	1,285		--
Convertible preferred stock	--	6		--
Convertible partnership units	--	--		4,304
Diluted EPS	\$ 20,620	53,963	\$0.38	\$49,736
	=====	=====	=====	=====

Net income has been reduced by preferred stock dividends of approximately \$8,517,000 and \$8,745,000 for the three months ended June 30, 2002 and 2001, respectively and approximately \$17,065,000 and \$17,394,000 for the six months ended June 30, 2002 and 2001, respectively.

The effects of convertible units in CarrAmerica Realty, L.P. and Carr Realty, L.P. and Series A Convertible Preferred Stock are not included in the computation of diluted earnings per share for any periods in which their effect is antidilutive.

(f) Derivative Financial Instruments

We manage our capital structure to reflect a long-term investment approach, generally seeking to match the stable return nature of our assets with fixed interest rate liabilities. We also utilize floating rate debt for short-term financing purposes or to protect against the risk, at certain times, that fixed rates may overstate our long-term costs of borrowing if assumed inflation or growth in the economy implicit in higher fixed interest rates do not materialize.

At times, our mix of variable and fixed-rate debt may not suit our needs. At those times, we may enter into interest rate swaps, forward interest rate options or interest rate options in order to assist us in managing our debt mix. We either will hedge our variable-rate debt to give it a fixed interest rate or hedge fixed-rate debt to give it a variable interest rate.

On May 8, 2002, we entered into an interest rate swap with JP Morgan Chase and Bank of America, hedging \$150.0 million of senior unsecured notes due July 2004. The interest rate swap matures at the same time the notes are due. The swap qualifies as a fair value hedge. Net quarterly settlement payments are recognized as an increase or decrease to interest expense. The fair value of the interest rate swap is recognized on our balance sheet and the carrying value of the senior unsecured notes is increased or decreased by an offsetting amount. As of June 30, 2002, the fair value of the interest rate swap was



## Edgar Filing: CARRAMERICA REALTY CORP - Form 10-Q

(Unaudited)

---

approximately \$1.7 million. We recognized a credit to interest expense for the three months ended June 30, 2002 of approximately \$507,000 related to the swap.

(g) Reclassifications

Certain reclassifications of prior period amounts have been made to conform to the current period's presentation.

(3) Obligations Under Lease Guarantees

On March 13, 2002, HQ Global Workplaces, Inc. (HQ Global) filed for bankruptcy protection under Chapter 11 of the federal bankruptcy laws. During 1997 and 1998, to assist HQ Global as it grew its business, we provided guarantees of HQ Global's performance under four office leases that it signed. To our knowledge, all monthly rent payments were made by HQ Global under two of these leases through January 2002, and rental payments under the other two leases were made through February 2002. As a result, we may be liable to the lessors with respect to payments due under two of these leases from and after February 2002 and under the other two leases from and after March 2002.

On June 1, 2000, we, along with HQ Global, VANTAS Incorporated (VANTAS) and FrontLine Capital Group (FrontLine), consummated several transactions including (i) the merger of VANTAS with and into HQ Global, (ii) the acquisition by FrontLine of shares of HQ Global common stock from us and other stockholders of HQ Global, and (iii) the acquisition by VANTAS of our debt and equity interest in OmniOffices (UK) Limited and OmniOffices LUX 1929 Holding Company S.A. In connection with these transactions, FrontLine agreed to indemnify us against any losses incurred with respect to guarantees of the four office leases. However, on June 12, 2002, FrontLine also filed for bankruptcy protection under Chapter 11 of the federal bankruptcy laws, and therefore it is unlikely that we will recover any resulting losses from FrontLine under this indemnity.

In the course of its bankruptcy proceedings, HQ Global has filed motions to reject two of these four leases. One lease is for space in San Jose, California. This lease is for approximately 22,000 square feet of space at two adjacent buildings and runs through October 2008. Total aggregate remaining lease payments under this lease as of February 1, 2002 were approximately \$6.2 million (approximately \$0.7 million of which is payable in 2002); however, our liability under this guarantee is limited to approximately \$2.0 million. As of June 30, 2002, we have reached an agreement in principal with the landlord of this lease pursuant to which we would pay \$1.75 million in full satisfaction of the guarantee. We recognized an expense for the full amount of our exposure under this guarantee in the first quarter of 2002; accordingly, we reduced the obligation recognized relating to this lease in the second quarter to \$1.75 million.

The second lease that was rejected by HQ Global is a sublease for space in downtown Manhattan. This lease is for approximately 26,000 square feet of space and runs through March 2008, with total aggregate remaining lease payments as of February 1, 2002 of approximately \$5.4 million (approximately \$0.8 million of which is payable in 2002). In June 2002, we received a demand for payment of the full amount of the guarantee. However, we believe that we have defenses to payment under this guarantee available to us and joined with HQ Global in filing suit on July 24, 2002 in HQ Global's bankruptcy proceedings asking the bankruptcy court to declare that

## Edgar Filing: CARRAMERICA REALTY CORP - Form 10-Q

the lease was terminated by the landlord of the sublease not later than February 28, 2002. On July 26, 2002, the landlord under the sublease filed suit in federal court in New York seeking payment from us under this guarantee. In light of our defenses and these proceedings, we have not accrued any expense relating to this guarantee; however, there can be no assurance as to the outcome of the pending litigation or that we will not incur expense or be required to make cash payments relating to this guarantee up to the full amount of the guarantee. As of June 30, 2002, we had not made any payments under this guarantee.

HQ Global has not filed a motion seeking to reject the remaining two leases that we have guaranteed, although it could do so in the future. Even if the leases are not rejected, we may ultimately be liable to the lessors for payments due under the leases. In one case, the lease is for approximately 25,000 square feet of space in midtown Manhattan, and our liability is currently capped at approximately \$0.6 million, which liability reduces over the life of the lease until its expiration in September 2007. We have not accrued any expense related to this guarantee as of June 30, 2002. As of June 30, 2002, we had not made any payments under this guarantee.

9

CARRAMERICA REALTY CORPORATION AND SUBSIDIARIES  
Note to Consolidated Financial Statement  
(Unaudited)

---

The remaining lease is for space in San Mateo, California. This lease is for approximately 19,000 square feet of space and runs through January 2013, with total aggregate remaining lease payments as of March 1, 2002 of approximately \$10.4 million (approximately \$0.6 million of which is payable in 2002). We initially recognized an expense of \$0.4 million under this guarantee in the first quarter of 2002 based on a tentative agreement with HQ Global under which HQ Global would not reject this lease obligation and we would fund HQ Global's operating losses at this location for a limited period of time. Due to deteriorating conditions in the local commercial real estate market, HQ Global subsequently determined that the tentative agreement was not in its best interest. HQ Global has now indicated to us that it intends to reject this lease unless its rent under this lease is reduced to current market rates. However, we entered into an agreement with HQ Global as of June 30, 2002 to fund operating losses at this location up to an aggregate amount of \$130,000 in exchange for HQ Global forbearing from rejecting this lease until September 15, 2002, or if it obtains from the bankruptcy court an extension of time within which to reject leases, November 1, 2002. Based on these changed circumstances, we have increased our provision for loss under this guarantee to \$6.9 million in the second quarter of 2002. This represents the amount we have determined to be our likely exposure under this guarantee as of June 30, 2002; however, there can be no assurance that we will not be required to further increase our provision or make cash payments related to this guarantee in future periods up to, in the aggregate, the full amount of the guarantee. We are currently exploring options to mitigate our exposure under this guarantee, including having the lease assigned to us and then subletting the space back to HQ Global or others. As of June 30, 2002, we had not made any payments under this guarantee.

(4) Gain (Loss) on Sale of Assets and Other Provisions, Net

We generally dispose of assets that are inconsistent with our long-term strategic or return objectives. During the three months ended June 30,

## Edgar Filing: CARRAMERICA REALTY CORP - Form 10-Q

2002, we disposed of one operating property, recognizing a gain of \$3.3 million. We continue to manage the property under a two-year management agreement and, accordingly, the operating results of the property and the gain on sale are not classified as discontinued operations. We recognized impairment losses of \$0.4 million on two parcels of land held for development during the three months ended June 30, 2002. During the three months ended June 30, 2001, we disposed of a parcel of land that was being held for development. The loss recognized on this transaction was immaterial.

During the six months ended June 30, 2002, we disposed of one operating property, recognizing a gain of \$3.3 million. We recognized impairment losses of \$1.3 million on three parcels of land held for development. During the six months ended June 30, 2001, we disposed of seven operating properties, one property under development and two parcels of land held for development. We recognized a gain of \$2.0 million, net of taxes of \$2.0 million. We also recognized an impairment loss of \$0.9 million on a parcel of land held for development during the six months ended June 30, 2001.

### (5) Segment Information

Our reportable operating segments are real estate property operations and development operations. Other business activities and operating segments that are not reportable are included in other operations. The real estate property operations segment includes the operation and management of rental properties (except for those properties managed for affiliates or third parties). The development operations segment includes the development of new rental properties for us and for other companies. Our reportable segments offer different products and services and are managed separately because each requires different business strategies and management expertise.

Our operating segments' performance is measured using funds from operations. Funds from operations is defined by the National Association of Real Estate Investment Trusts (NAREIT) as follows:

- . Net income - computed in accordance with accounting principles generally accepted in the United States of America (GAAP);
- . Less gains (or plus losses) from sales of operating properties and items that are classified as extraordinary items under GAAP;
- . Plus depreciation and amortization of assets uniquely significant to the real estate industry;

10

CARRAMERICA REALTY CORPORATION AND SUBSIDIARIES  
Note to Consolidated Financial Statement  
(Unaudited)

---

- . Plus or minus adjustments for unconsolidated partnerships and joint ventures (to reflect funds from operations on the same basis).

Funds from operations does not represent net income or cash flow generated from operating activities in accordance with GAAP. As such, it should not be considered an alternative to net income as an indication of our performance or to cash flows as a measure of our liquidity or our ability

## Edgar Filing: CARRAMERICA REALTY CORP - Form 10-Q

to make distributions.

Operating results of our reportable segments and our other operations for the three and six months ended June 30, 2002 and 2001 are summarized and reconciled to net income for the applicable period as follows:

For the three months ended June 30, 2002				
(In millions)	Real Estate Property Operations	Development Operations	Other Operations	Total
Operating revenue	\$124.0	1.8	3.7	\$129.5
Segment expense	40.8	2.1	6.1	49.0
Net segment revenue (expense)	83.2	(0.3)	(2.4)	80.5
Interest expense	8.3	--	16.1	24.4
Other income (expense), net	5.1	--	(7.6)	(2.5)
Funds from operations	\$ 80.0	(0.3)	(26.1)	53.6
Depreciation and amortization				(32.8)
Income from operations before minority interest, income taxes and gain (loss) on sale of assets and other provisions, net				20.8
Minority interest, income taxes and gain (loss) on sale of assets and other provisions, net				(0.6)
Net income				\$ 20.2

For the three months ended June 30, 2001				
(In millions)	Real Estate Property Operations	Development Operations	Other Operations	Total
Operating revenue	\$123.8	4.6	5.1	\$133.5
Segment expense	38.4	1.1	10.4	49.9
Net segment revenue (expense)	85.4	3.5	(5.3)	83.6
Interest expense	11.3	--	9.8	21.1
Other income (expense), net	5.4	0.1	(0.3)	5.2
Funds from operations	\$ 79.5	3.6	(15.4)	67.7
Depreciation and amortization				(31.6)
Income from operations before				

Edgar Filing: CARRAMERICA REALTY CORP - Form 10-Q

minority interest, income taxes and gain (loss) on sale of assets and other provisions net, net	36.1
Minority interest, income taxes and gain (loss) on sale of assets and other provisions, net	(3.5)
	-----
Net income	\$ 32.6
	=====

11

CARRAMERICA REALTY CORPORATION AND SUBSIDIARIES  
Notes to Consolidated Financial Statements  
(Unaudited)

(In millions)	For the six months ended June 30, 2002			
	Real Estate Property Operations	Development Operations	Other Operations	Tot
Operating revenue	\$251.2	4.5	7.1	\$262.8
Segment expense	83.4	4.1	15.1	102.6
	-----	---	-----	-----
Net segment revenue (expense)	167.8	0.4	(8.0)	160.2
Interest expense	16.6	--	32.2	48.8
Other income (expense), net	10.3	--	(11.4)	(0.7)
	-----	---	-----	-----
Funds from operations	\$161.5	0.4	(51.6)	110.3
	=====	===	=====	-----
Depreciation and amortization				(68.0)
				-----
Income from operations before minority interest, income taxes and gain (loss) on sale of assets and other provisions net, net				41.3
Minority interest, income taxes and gain (loss) on sale of assets and other provisions, net				(4.0)
				-----
				\$ 37.3
				=====

(In millions)	For the six months ended June 30, 2001			
	Real Estate Property Operations	Development Operations	Other Operations	Tot
Operating revenue	\$247.6	10.8	9.0	\$267.4

Edgar Filing: CARRAMERICA REALTY CORP - Form 10-Q

Segment expense	80.1	2.6	23.0	105
	-----	---	-----	-----
Net segment revenue (expense)	167.5	8.2	(14.0)	161
Interest expense	22.4	--	19.6	42
Other income (expense), net	12.4	0.3	(1.4)	11
	-----	---	-----	-----
Funds from operations	\$157.5	8.5	(35.0)	131
	=====	===	=====	
Depreciation and amortization				(64)
				-----
Income from operations before minority interest and gain (loss) on sale of assets and other provisions, net				67
Minority interest, income taxes and gain (loss) on sale of assets and other provisions, net				(4)
				-----
Net income				\$ 62
				=====

(6) Supplemental Cash Flow Information

In the first quarter of 2002, 80,000 shares of our Series A Cumulative Convertible Redeemable Preferred Stock were converted to shares of common stock, retiring all remaining shares of Series A Cumulative Convertible Redeemable Preferred Stock.

Our employees converted approximately \$0.7 million and \$0.8 million in units to 31,797 shares and 25,131 shares of common stock during the six months ended June 30, 2002 and 2001, respectively.

In April 2001, we exercised an option under a loan agreement to acquire two office buildings and related land located in the San Francisco Bay area. For financial reporting purposes, we had classified the loan as an investment in an unconsolidated entity and accounted for it using the equity method. The investment, which had a carrying value of approximately \$50.3 million at the date the option was exercised, was reclassified to rental property in connection with this transaction.

12

CARRAMERICA REALTY CORPORATION AND SUBSIDIARIES  
Notes to Consolidated Financial Statements  
(Unaudited)

On June 29, 2001, we contributed land subject to a note payable of approximately \$26.0 million to a joint venture in exchange for a 30% ownership interest. Our initial investment in the joint venture amounted to \$7.3 million, the net book value of the asset and liability contributed.

In the second quarter of 2001, 400,000 shares of our Series A Cumulative Convertible Redeemable Preferred Stock were converted to shares of common stock.

(7) Subsequent Events

On August 8, 2002, we called 4,000,000 shares of our Series B Cumulative Redeemable Preferred Stock for redemption. The redemption date is September

## Edgar Filing: CARRAMERICA REALTY CORP - Form 10-Q

7, 2002. The Series B Preferred Stock will be redeemed at a redemption price of \$25.00 per share plus \$0.041201 per share in accrued and unpaid dividends for the period September 1, 2002 through and including the redemption date, without interest. This will result in a cash expenditure of approximately \$100.2 million in September 2002, which we expect to fund by drawing down on our \$500 million unsecured credit facility.

Our unsecured credit facility contained a financial covenant requiring us to maintain at least \$1.1 billion of tangible net worth (as defined by the facility). After giving effect to the proposed redemption of our Series B Preferred Stock, we would have been in violation of that covenant. Therefore, we sought and the banks agreed to on July 29, 2002 an amendment to the facility, reducing the minimum tangible net worth requirement to \$ 800.0 million.

13

### Management's Discussion and Analysis

---

#### Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The discussion that follows is based primarily on our consolidated financial statements as of June 30, 2002 and December 31, 2001 and for the three and six months ended June 30, 2002 and 2001 and should be read along with the consolidated financial statements and related notes. The ability to compare one period to another may be significantly affected by acquisitions completed, development properties placed in service and dispositions made during those periods.

#### Critical Accounting Policies

Critical accounting policies are those that are both important to the presentation of our financial condition and results of operations and require management's most difficult, complex or subjective judgments. Our critical accounting policies relate to the evaluation of impairment of long-lived assets and the evaluation of the collectibility of accounts and notes receivable.

If events or changes in circumstances indicate that the carrying value of a rental property to be held and used or land held for development may be impaired, we perform a recoverability analysis based on estimated undiscounted cash flows to be generated from the property in the future. If the analysis indicates that the carrying value is not recoverable from future cash flows, the property is written down to estimated fair value and an impairment loss is recognized. If we decide to sell rental properties or land held for development, we evaluate the recoverability of the carrying amounts of the assets. If the evaluation indicates that the carrying value is not recoverable from estimated net sales proceeds, the property is written down to estimated fair value less costs to sell and an impairment loss is recognized within income from continuing operations. Our estimates of cash flows and fair values of the properties are based on current market conditions and consider matters such as rental rates and occupancies for comparable properties, recent sales data for comparable properties and, where applicable, contracts or the results of negotiations with purchasers or prospective purchasers. Our estimates are subject to revision as market conditions and our assessments of them change.

Our allowance for doubtful accounts receivable is established based on analysis of the risk of loss on specific accounts. The analysis places particular emphasis on past-due accounts and considers information such as the

## Edgar Filing: CARRAMERICA REALTY CORP - Form 10-Q

nature and age of the receivable, the payment history of the tenant or other debtor, the financial condition of the tenant and our assessment of its ability to meet its lease obligations, the basis for any disputes and the status of related negotiations, etc. Our estimate of the required allowance, which is reviewed on a quarterly basis, is subject to revision as these factors change and is sensitive to the effects of economic and market conditions on our tenants, particularly in our largest markets (i.e., the San Francisco Bay and Washington, D.C. areas). For example, due to economic conditions and analysis of our accounts receivable, we increased our provision for uncollectible accounts (and related straight-line rent adjustments) by approximately \$5.5 million in 2001 and by an additional \$3.1 million in the first half of 2002.

### Results Of Operations

The discussion and analysis of operating results focuses on our segments as management believes that segment analysis provides the most effective means of understanding the business. Our reportable operating segments are real estate property operations and development operations. Other business activities and operations, which are not reported separately, are included in other operations.

Our operating segments' performance is measured using funds from operations. Funds from operations is defined by the National Association of Real Estate Investment Trusts (NAREIT) as follows:

- .. Net income - computed in accordance with accounting principles generally accepted in the United States of America (GAAP);
- .. Less gains (or plus losses) from sales of operating properties and items that are classified as extraordinary items under GAAP;
- .. Plus depreciation and amortization of assets uniquely significant to the real estate industry;
- .. Plus or minus adjustments for unconsolidated partnerships and joint ventures (to reflect funds from operations on the same basis).

Funds from operations does not represent net income or cash flow generated from operating activities in accordance with GAAP. As such, it should not be considered an alternative to net income as an indication of our performance or to cash flows as a measure of our liquidity or our ability to make distributions.

14

### Management's Discussion and Analysis

---

#### Real Estate Property Operations

Operating results of real estate property operations are summarized as follows:

(in millions)	For the three months ended June 30,		Variance ----- 2002 vs. 2001	For the six months ended June 30,		Variance ----- 2002 vs. 2001
	2002	2001		2002	2001	
	-----	-----	-----	-----	-----	-----
Operating revenue	\$124.0	\$123.8	\$ 0.2	\$251.2	\$247.6	\$ 3.6



## Edgar Filing: CARRAMERICA REALTY CORP - Form 10-Q

Segment expense	40.8	38.4	2.4	83.4	80.1	3.3
Interest expense	8.3	11.3	(3.0)	16.6	22.4	(5.8)
Other income, net	5.1	5.4	(0.3)	10.3	12.4	(2.1)

=====

Real estate operating revenues increased \$0.2 million (0.2%) for the three months ended June 30, 2002 as compared to 2001. This increase resulted from development properties being placed in service, partially offset by higher vacancy rates and sold properties. Same store rental revenues declined by approximately 1.8% (approximately \$2.2 million). This decrease was due primarily to increases in vacant space and declining rental rates in most of our markets.

Real estate operating revenues increased \$3.6 million (1.5%) for the six months ended June 30, 2002 as compared to 2001. This increase was attributable to the factors mentioned. Same store rental revenues declined by \$1.2 million (0.5%). This decrease was due primarily to the factors mentioned above.

Real estate operating expenses increased \$2.4 million (6.3%) for the second quarter of 2002 as compared to the same period in 2001. This increase was due primarily to an increase in real estate taxes of \$1.2 million and higher bad debt expense of approximately \$1.5 million due to tenant bankruptcies and collection issues. In 2001, the addition to the provision for uncollectible accounts for the second quarter was \$0.1 million.

Real estate operating expenses increased \$3.3 million (4.1%) for the six months ended June 30, 2002 as compared to 2001. This increase was primarily attributable to higher real estate taxes of \$3.4 million and insurance of \$1.5 million partially offset by a lower provision of uncollectible accounts of \$1.6 million.

Real estate interest expense decreased \$3.0 million (26.5%) in the second quarter of 2002 as compared to the same period in 2001. This decrease was principally the result of the retirement of mortgages due to maturities or dispositions of related properties. For the first six months of 2002, real estate interest expense decreased \$5.8 million (25.9%) due to the same factors.

Real estate other income decreased \$0.3 million (5.6%) for the three months ended June 30, 2002 as compared to the three months ended June 30, 2001. This decrease was primarily the result of a decline of \$1.5 million from equity in earnings of unconsolidated entities (excluding depreciation), principally from reduced earnings from our investment in Carr Office Park, L.L.C. Carr Office Park, L.L.C. obtained third party financing on its properties in June 2001, resulting in increased interest expense and therefore reduced earnings. This decrease in earnings from unconsolidated entities was partially offset by an increase in depreciation expense, which is added back for funds from operations purposes, of \$1.2 million from equity investments. Real estate other income decreased \$2.1 million (16.9%) for the six months ended June 30, 2002 compared to the six months ended June 30, 2001 for the reason mentioned above.

As a result of the economic climate in 2001, the real estate markets materially softened. Demand for office space declined significantly and vacancy rates increased in each of our core markets. During the first half of 2002, our core markets continued to weaken and we expect them to remain weak through the balance of the year. As a result, occupancy in our portfolio of operating properties decreased to 93.6% at June 30, 2002, as compared to 93.9% at March 31, 2002 and 97.2% at June 30, 2001. We expect occupancy levels in our portfolio to average approximately 93.0% for 2002. Market rental rates have declined in most markets from peak levels. Rental rates on space that was re-leased in the first half of 2002 decreased an average of 6.2% in comparison to rates that were in effect under expiring leases.

## Management's Discussion and Analysis

## Development Operations

Operating results of development operations are summarized as follows:

(in millions)	For the three months ended		Variance	For the six months ended		Variance
	June 30,			June 30,		
	2002	2001	2002 vs. 2001	2002	2001	2002 vs. 2001
Operating revenue	\$1.8	\$4.6	\$(2.8)	\$4.5	\$10.8	\$(6.3)
Segment expense	2.1	1.1	1.0	4.1	2.6	1.5
Interest expense	--	--	--	--	--	--
Other income, net	--	0.1	(0.1)	--	0.3	(0.3)

Revenue from our development operations decreased \$2.8 million (60.9%) for the second quarter of 2002 compared to the second quarter of 2001 primarily because we earned one-time incentive fees (\$2.6 million) related to the development of properties in the second quarter of 2001. For the six months ended June 30, 2002, revenue from our development operations decreased \$6.3 million (58.3%), largely for the same reason.

Operating expenses for our development operations increased \$1.0 million (90.9%) for the three months ended June 30, 2002 as compared to the three months ended June 30, 2001 due to a decline in capitalized personnel and related costs as a result of development operations' focus on third party activity in 2002. Operating expenses for our development operations increased \$1.5 million (57.7%) for the first half of 2002 compared to the first half of 2001 for the same reason.

## Other Operations

Operating results of other operations are summarized as follows:

(in millions)	For the three months ended		Variance	For the six months ended		Variance
	June 30,			June 30,		
	2002	2001	2002 vs. 2001	2002	2001	2002 vs. 2001
Operating revenue	\$ 3.7	\$ 5.1	\$(1.4)	\$ 7.1	\$ 9.0	\$(1.9)
Segment expense	6.1	10.4	(4.3)	15.1	23.0	(7.9)
Interest expense	16.1	9.8	6.3	32.2	19.6	12.6
Other expense, net	(7.6)	(0.4)	(7.2)	(11.4)	(1.4)	(10.0)

## Edgar Filing: CARRAMERICA REALTY CORP - Form 10-Q

Revenues from our other operations decreased \$1.4 million (27.5%) in the second quarter of 2002 as compared to the second quarter of 2001. The decrease in 2002 resulted primarily from declines in leasing fee revenue as a result of the increasing vacancy rates and reduced rental activity in properties we manage for affiliates and third parties. For the six months ended June 30, 2002, revenues from our other operations decreased \$1.9 million (21.1%) as compared to the same period a year ago for the same reason.

Expenses of our other operations decreased \$4.3 million (41.3%) in the three months ended June 30, 2002 compared to the three months ended June 30, 2001. The decrease was due primarily to the completion of portions of our internal process improvement efforts and increased allocations of technology-related and other expenses to the operating properties. Expenses of our other operations decreased \$7.9 million (34.3%) for the first half of 2002 compared to the first half of 2001 for the same reasons.

Interest expense increased \$6.3 million (64.3%) during the second quarter of 2002 compared to the second quarter of 2001 due primarily to higher debt levels partially offset by a decrease in short-term interest rates on variable rate debt. Interest expense increased \$12.6 million (64.3%) for the six months ended June 30, 2002 as compared to the six months ended June 30, 2001 due to higher debt levels.

Other expense increased \$7.2 million for the second quarter of 2002 compared to the second quarter of 2001. Other expense increased \$10.0 million for the six months ended June

16

### Management's Discussion and Analysis

---

30, 2001. These increases were due primarily to the accrual of costs related to potential obligations under lease guarantees for HQ Global Workplaces, Inc.

#### Depreciation and Amortization

Depreciation and amortization increased \$1.2 million (3.8%) in the second quarter of 2002 compared to the second quarter of 2001. This increase was due primarily to development properties being placed into service, partially offset by dispositions of interests in properties. For the six months ended June 30, 2002, depreciation and amortization increased \$4.5 million (7.0%) from the six months ended June 30, 2001 for the same reasons.

#### Gain (Loss) on Sale of Assets and Other Provisions, Net

We generally dispose of assets that are inconsistent with our long-term strategic or return objectives. The proceeds from the sales are redeployed into other properties or used to fund development operations or to support other corporate needs. During the three months ended June 30, 2002, we disposed of one operating property, recognizing a gain of \$3.3 million. We continue to manage the property under a two-year management agreement and, accordingly, the operating results of the property and the gain on sale are not classified as discontinued operations. We recognized an impairment loss on \$0.4 million on a parcel of land that is held for development during the three months ended June 30, 2002. During the three months ended June 30, 2001, we disposed of a parcel of land held for development. The loss recognized on this transaction was immaterial.

## Edgar Filing: CARRAMERICA REALTY CORP - Form 10-Q

During the six months ended June 30, 2002, we disposed of one operating property mentioned above and recognized impairment losses of \$1.3 million on two parcels of land that is held for development. During the six months ended June 30, 2001, we disposed of seven operating properties, one property under development and two parcels of land that was being held for development. We recognized a gain of \$2.0 million, net of \$2.0 million in income taxes. During that period, we also recognized an impairment loss of \$0.9 million on a parcel of land held for development.

### Consolidated Cash Flows

Consolidated cash flow information is summarized as follows:

(in millions)	For the six months ended June 30,		Variance 2002 vs. 2001
	2002	2001	
Cash provided by operating activities	\$110.8	\$ 93.8	\$ 17.0
Cash (used by) provided by investing activities	(28.8)	154.8	(183.6)
Cash used by financing activities	(82.5)	(258.8)	176.3

Operations generated \$110.8 million of net cash in 2002 compared to \$93.8 million in 2001. The changes in cash flow from operating activities were primarily the result of factors discussed above in the analysis of operating results. The level of net cash provided by operating activities is also affected by the timing of receipt of revenues and payment of expenses, including in 2001 the payment of income taxes relating to the sale of certain assets in 2000.

Our investing activities used net cash of \$28.8 million in 2002 and provided net cash of \$154.8 million in 2001. The change in net cash provided by investing activities in 2002 is due primarily to the fact that 2001 included higher proceeds from sales of properties (\$89.8 million), a distribution from Carr Office Park, L.L.C. of proceeds from a third party financing of its properties (\$77.9 million), the release of a restricted deposit in connection with a property transaction (\$32.5 million) and principal payments on a note receivable (\$16.5 million). We also had higher acquisitions of rental properties in 2002 (\$18.3 million). The effects of these changes were partially offset by a reduction in acquisitions of land held for development (\$33.6 million), a decrease in development activities (\$16.6 million) and a reduction in investments in unconsolidated entities (\$6.4 million).

Our financing activities used net cash of \$82.5 million in 2002 and \$258.8 million in 2001. The decrease in net cash used by financing activities in 2002 is due primarily to a suspension of our common stock buyback program (\$119.2 million). In addition, net repayments of debt were lower in 2002 (\$64.0 million). Also, dividend payments were lower in 2002 (\$5.6 million) due to the repurchase of common stock. Partially offsetting these changes was our repurchase of \$20.7 million of preferred stock during the second quarter of 2002.

LIQUIDITY AND CAPITAL RESOURCES

As of June 30, 2002, we had approximately \$4.5 million in available cash and cash equivalents. As a REIT, we are required to distribute at least 90% of our taxable income to our stockholders on an annual basis. In addition, we and our affiliates require capital to invest in our existing portfolio of operating assets for capital projects. These capital projects can include such things as large-scale renovations, routine capital improvements, deferred maintenance on properties we have recently acquired and tenant related matters, including tenant improvements, allowances and leasing commissions. Therefore, as a general matter, it is unlikely our cash balances would satisfy our liquidity needs. Instead, these needs must be met from cash generated from rental and real estate service revenue and external sources of capital.

We derive substantially all of our revenue from tenants under existing leases at our properties. Our operating cash flow therefore depends materially on the rents that we are able to charge to our tenants, and the ability of these tenants to make their rental payments. We believe that the diversity of our tenant base (no tenant accounted for more than 5% of annualized revenue as of June 30, 2002) helps insulate us from the negative impact of tenant defaults and bankruptcies. However, general economic downturns, or economic downturns in one or more of our core markets, still may adversely impact the ability of our tenants to make lease payments and our ability to re-lease space on favorable terms as leases expire. In either of these cases, our cash flow and therefore our ability to meet our capital needs would be adversely affected.

We seek to create and maintain a capital structure that will enable us to diversify our capital resources. This should allow us to obtain additional capital from a number of different sources. These sources could include additional equity offerings of common stock and/or preferred stock, public and private debt financings and possible asset dispositions. Our management believes that we will have access to the capital resources necessary to expand and develop our business, to fund our operating and administrative expenses, to continue to meet our debt service obligations, to pay dividends in accordance with REIT requirements, to acquire additional properties and land and to pay for construction in progress.

We have three investment grade ratings. As of June 30, 2002, Fitch Rating Services and Standard & Poors have each assigned their BBB rating to our prospective senior unsecured debt offerings and their BBB- rating to our prospective cumulative preferred stock offerings. Moody's Investor Service has assigned a negative outlook and its Baa2 rating to our prospective senior unsecured debt offerings and its Baa3 rating to our prospective cumulative preferred stock offerings. A downgrade in outlook or rating by any one of these rating agencies could result from, among other things, a change in our financial position or a downturn in general economic conditions. Any such downturn could adversely affect our ability to obtain future financing or could increase costs of existing debt.

Our total debt at June 30, 2002 was approximately \$1.4 billion, of which \$88.0 million (6.3%) bore a LIBOR-based floating interest rate. The interest rate on borrowings on our unsecured credit facility at June 30, 2002 was 2.54%. Our fixed rate mortgage payable debt bore an effective weighted average interest rate of 7.97% at June 30, 2002. The weighted average term of this debt is 6.8 years. At June 30, 2002, our debt represented 39.2% of our total market capitalization of \$3.6 billion.

We manage our capital structure to reflect a long-term investment approach, generally seeking to match the stable return nature of our assets with fixed interest rate liabilities. We also utilize floating rate debt for

## Edgar Filing: CARRAMERICA REALTY CORP - Form 10-Q

short-term financing purposes or to protect against the risk, at certain times, that fixed rates may overstate our long-term costs of borrowing if assumed inflation or growth in the economy implicit in higher fixed interest rates do not materialize. At times, our mix of variable and fixed-rate debt may not suit our needs. At those times, we may enter into interest rate swaps, forward interest rate options or interest rate options in order to assist us in managing our debt mix. We either will hedge our variable-rate debt to give it a fixed interest rate or hedge fixed-rate debt to give it a variable interest rate.

On May 8, 2002, we entered into an interest rate swap with JP Morgan Chase and Bank of America, hedging \$150.0 million of senior unsecured notes due July 2004. The interest rate swap matures at the same time the notes are due. The swap qualifies as a fair value hedge. Net quarterly settlement payments are recognized as an increase or decrease to interest expense. The fair value of the interest rate swap is recognized on our balance sheet and the carrying value of the senior unsecured notes is increased or decreased by an offsetting amount. As of June 30, 2002, the fair value of the interest rate swap was approximately \$1.7 million. We recognized a credit to interest expense for the three

18

### Management's Discussion and Analysis

---

months ended June 30, 2002 of approximately \$507,000 related to the swap. As of June 30, 2002, taking into account the effect of the interest rate swap, the effective interest rate on the notes was reduced to 5.85%.

Our primary external source of liquidity is our credit facility. We have a three-year \$500 million unsecured credit facility expiring in June 2004 with J.P. Morgan Chase, as agent for a group of banks. We can extend the life of the line an additional year at our option. The line carries an interest rate of 70 basis points over 30-day LIBOR. As of June 30, 2002, \$88.0 million was drawn on the credit facility, \$2.3 million in letters of credit were outstanding and we had \$409.7 million available for borrowing.

Our unsecured credit facility contains financial and other covenants with which we must comply. Some of these covenants include:

- .. A minimum ratio of annual EBITDA (earnings before interest, taxes, depreciation and amortization) to interest expense;
- .. A minimum ratio of annual EBITDA to fixed charges;
- .. A maximum ratio of total debt to tangible fair market value of our assets; and
- .. Restrictions on our ability to make dividend distributions in excess of 90% of funds from operations.

Availability under the unsecured credit facility is also limited to a specified percentage of the fair value of our unmortgaged properties.

In January 2002, we issued \$400.0 million of senior unsecured notes. The notes bear interest at 7.125% per annum payable semi-annually beginning on July 15, 2002. The notes mature on January 15, 2012. The notes are unconditionally guaranteed by CarrAmerica Realty, L.P., one of our subsidiaries.

Our senior unsecured notes also contain covenants with which we must comply. These include:

- .. Limits on our total indebtedness on a consolidated basis;
- .. Limits on our secured indebtedness on a consolidated basis; and

## Edgar Filing: CARRAMERICA REALTY CORP - Form 10-Q

.. Limits on our required debt service payments.

As a result of the economic climate in 2001, the real estate markets materially softened. Demand for office space declined significantly and vacancy rates increased in each of our core markets. During the first half of 2002, our core markets continued to weaken and we expect them to remain weak through the balance of the year. As a result, occupancy in our portfolio of operating properties decreased to 93.6% at June 30, 2002, as compared to 93.9% at March 31, 2002 and 97.2% at June 30, 2001. We expect occupancy levels in our portfolio to average approximately 93.0% for 2002. Market rental rates have declined in most markets from peak levels. Rental rates on space that was re-leased in the first half of 2002 decreased an average of 6.2% in comparison to rates that were in effect under expiring leases.

We will require capital for development projects currently underway and in the future. As of June 30, 2002, we had approximately 115,500 square feet of office space in two development projects in progress. Our total expected investment on these projects is \$16.1 million. Through June 30, 2002, we had invested \$10.2 million or 63.4% of the total expected investment for these projects. We also have a residential project under development as part of a development project in a joint venture. Our total expected investment in the residential project is expected to be \$20.3 million. As of June 30, 2002, we had invested \$1.8 million in this project. As of June 30, 2002, we also had 900,000 square feet of office space under construction in five projects in which we own minority interests. These projects are expected to cost \$256.0 million, of which our total investment is expected to be approximately \$76.8 million. Through June 30, 2002, approximately \$124.8 million or 48.8% of total project costs had been expended on these projects. We have financed our investment in projects under construction at June 30, 2002 primarily from borrowings under our credit facility. We expect that this source and project-specific financing of selected assets will provide additional funds required to complete existing development and to finance the costs of additional projects we may undertake. As a result of market conditions, we believe we will be limiting our development activities in the near future and expect to concentrate our growth efforts on the acquisition of properties.

On August 8, 2002, we called 4,000,000 shares of our Series B Cumulative Redeemable Preferred Stock for redemption. The redemption date is September 7, 2002. The Series B Preferred Stock will be redeemed at a

19

### Management's Discussion and Analysis

---

redemption price of \$25.00 per share plus \$0.041201 per share in accrued and unpaid dividends for the period September 1, 2002 through and including the redemption date, without interest. This will result in a cash expenditure of approximately \$100.2 million in September 2002, which we expect to fund by drawing down on our \$500 million unsecured credit facility.

Our unsecured credit facility contained a financial covenant requiring us to maintain at least \$1.1 billion of tangible net worth (as defined by the facility). After giving effect to the proposed redemption of our Series B Preferred Stock, we would have been in violation of that covenant. Therefore, we sought and the banks agreed to an amendment to the facility, reducing the minimum tangible net worth requirement to \$ 800.0 million.

We also regularly incur expenditures in connection with the re-leasing of office space, principally in the form of tenant improvements and leasing

## Edgar Filing: CARRAMERICA REALTY CORP - Form 10-Q

commissions. The amounts of these expenditures can vary significantly, depending on negotiations with tenants and the willingness of tenants to pay higher base rents over the life of the leases. We expect to pay for these capital expenditures out of cash from operations or, to the extent necessary, draws on our line of credit. We believe that these expenditures are recouped in the form of continuing lease payments.

In the future, if, as a result of general economic downturns, a rating downgrade or otherwise, our properties do not perform as expected, or we cannot raise the expected funds from the sale of properties and/or if we are unable to obtain capital from other sources, we may not be able to make required principal and interest payments or make necessary routine capital improvements with respect to our existing portfolio of operating assets. While we believe that we would continue to have sufficient funds to pay our operating expenses and debt service and our regular quarterly dividends, our ability to expand our development activity or to fund acquisition of new properties could be adversely affected. In addition, if a property is mortgaged to secure payment of indebtedness and we are unable to meet mortgage payments, the holder of the mortgage could foreclose on the property, resulting in loss of income and asset value. An unsecured lender could also attempt to foreclose on some of our assets in order to receive payment. In many cases, very little of the principal amount that we borrow is repaid prior to the maturity of the loan. We generally expect to refinance that debt when it matures, although in some cases we may pay off the loan. If principal amounts due at maturity cannot be refinanced, extended or paid with proceeds of other capital transactions, such as new equity capital, our cash flow may be insufficient to repay all maturing debt. Prevailing interest rates or other factors at the time of a refinancing (such as possible reluctance of lenders to make commercial real estate loans) may result in higher interest rates and increased interest expense.

Our ability to raise funds through sales of debt and equity securities is dependent on, among other things, general market conditions for REITs, market perceptions about us, our debt rating and the current trading price of our stock. We will continue to analyze which source of capital is most advantageous to us at any particular point in time, but the capital markets may not consistently be available on terms that are attractive.

Our Board of Directors has authorized us to spend up to \$325 million to repurchase our common shares, preferred shares and debt securities excluding the 9.2 million shares repurchased from Security Capital in November 2001 which was separately approved. Since the start of this program in mid-2000 through June 30, 2002, we have acquired approximately 8.7 million of our common shares for an aggregate purchase price of approximately \$253.4 million.

During the second quarter of 2002, we repurchased 0.8 million shares of our preferred stock for \$20.7 million. We continue to monitor market conditions and other alternative investments in order to evaluate whether investment in our securities is appropriate.

We pay dividends quarterly. The maintenance of these dividends is subject to various factors, including the discretion of the Board of Directors, the ability to pay dividends under Maryland law, the availability of cash to make the necessary dividend payments and the effect of REIT distribution requirements, which require at least 90% of our taxable income to be distributed to stockholders. In addition, under our line of credit, we generally are restricted from paying dividends that would exceed 90% of our funds from operations during any four-quarter period.

Although we believe our properties are adequately covered by insurance, we cannot predict at this time if we will be able to obtain full coverage at a reasonable cost in the future. The costs associated with our June 30, 2002 property and casualty insurance renewals were higher than anticipated.



## Edgar Filing: CARRAMERICA REALTY CORP - Form 10-Q

Although we have an excellent claims history and safety record, all lines of coverage were affected by higher premiums, in part because insurance companies have

20

### Management's Discussion and Analysis

---

experienced a loss of income on their investments, underwriting results have been poor and also as a result of the events of September 11, 2001.

Our insurance renewal on June 30, 2002 increased premiums from last year approximately 155%. The property insurance deductible increased from \$5,000 to \$10,000 per claim. Since reinsurance treaties renew twice each year (January and July), our property and casualty insurance renewal date has been changed from June 30 to May 15 to enable underwriters to concentrate on the insurance proposals well ahead of treaty renewal.

Early this year, all risk property insurers began attaching terrorism exclusions to insurance policies. Terrorism insurance must now be purchased separately. Unlike earthquake exposure, insurers do not yet have a means of modeling the terrorism risk. A limited number of companies are currently underwriting terrorism insurance, with limited capacity and at an extremely high cost.

We have completed an in-depth asset evaluation of our terrorism exposure as well as our lender requirements. Upon our renewal date for insurance of June 30, 2002, we purchased terrorism limits of \$200 million per occurrence and in the aggregate, with a deductible of \$1.0 million per claim at a cost of approximately \$2.2 million. The policy covers only physical damage. Coverage does not include biological, chemical or radioactive contamination.

On March 13, 2002, HQ Global Workplaces, Inc. (HQ Global) filed for bankruptcy protection under Chapter 11 of the federal bankruptcy laws. During 1997 and 1998, to assist HQ Global as it grew its business, we provided guarantees of HQ Global's performance under four office leases that it signed. To our knowledge, all monthly rent payments were made by HQ Global under two of these leases through January 2002, and rental payments under the other two leases were made through February 2002. As a result, we may be liable to the lessors with respect to payments due under two of these leases from and after February 2002 and under the other two leases from and after March 2002.

On June 1, 2000, we, along with HQ Global, VANTAS Incorporated (VANTAS) and FrontLine Capital Group (FrontLine), consummated several transactions including (i) the merger of VANTAS with and into HQ Global, (ii) the acquisition by FrontLine of shares of HQ Global common stock from us and other stockholders of HQ Global, and (iii) the acquisition by VANTAS of our debt and equity interest in OmniOffices (UK) Limited and OmniOffices LUX 1929 Holding Company S.A. In connection with these transactions, FrontLine agreed to indemnify us against any losses incurred with respect to guarantees of the four office leases. However, on June 12, 2002, FrontLine also filed for bankruptcy protection under Chapter 11 of the federal bankruptcy laws, and therefore it is unlikely that we will recover any resulting losses from FrontLine under this indemnity.

In the course of its bankruptcy proceedings, HQ Global has filed motions to reject two of these four leases. One lease is for space in San Jose, California. This lease is for approximately 22,000 square feet of space at two adjacent buildings and runs through October 2008. Total aggregate remaining

## Edgar Filing: CARRAMERICA REALTY CORP - Form 10-Q

lease payments under this lease as of February 1, 2002 were approximately \$6.2 million (approximately \$0.7 million of which is payable in 2002); however, our liability under this guarantee is limited to approximately \$2.0 million. As of June 30, 2002, we have reached an agreement in principal with the landlord of this lease pursuant to which we would pay \$1.75 million in full satisfaction of the guarantee. We recognized an expense for the full amount of our exposure under this guarantee in the first quarter of 2002; accordingly, we reduced the obligation recognized relating to this lease in the second quarter to \$1.75 million.

The second lease was rejected by HQ Global is a sublease for space in downtown Manhattan. This lease is for approximately 26,000 square feet of space and runs through March 2008, with total aggregate remaining lease payments as of February 1, 2002 of approximately \$5.4 million (approximately \$0.8 million of which is payable in 2002). In June 2002, we received a demand for payment of the full amount of the guarantee. However, we believe that we have defenses to payment under this guarantee available to us and joined with HQ Global in filing suit on July 24, 2002 in HQ Global's bankruptcy proceedings asking the bankruptcy court to declare that the lease was terminated by the landlord of the sublease not later than February 28, 2002. On July 26, 2002 the landlord under the sublease filed suit in federal court in New York seeking payment from us under this guarantee. In light of our defenses and these proceedings, we have not accrued any expense relating to this guarantee; however, there can be no assurance as to the outcome of the pending litigation or that we will not incur expense or be required to make cash payments relating to this guarantee up to the full amount of the guarantee. As of June 30, 2002, we had not made any payments under this guarantee.

21

### Management's Discussion and Analysis

---

HQ Global has not filed a motion seeking to reject the remaining two leases that we have guaranteed, although it could do so in the future. Even if the leases are not rejected, we may ultimately be liable to the lessors for payments due under the leases. In one case, the lease is for approximately 25,000 square feet of space in midtown Manhattan, and our liability is currently capped at approximately \$0.6 million, which liability reduces over the life of the lease until its expiration in September 2007. We have not accrued any expense related to this guarantee as of June 30, 2002. As of June 30, 2002, we had not made any payments under this guarantee.

The remaining lease is for space in San Mateo, California. This lease is for approximately 19,000 square feet of space and runs through January 2013, with total aggregate remaining lease payments as of March 1, 2002 of approximately \$10.4 million (approximately \$0.6 million of which is payable in 2002). We initially recognized an expense of \$0.4 million under this guarantee in the first quarter of 2002 based on a tentative agreement with HQ Global under which HQ Global would not reject this lease obligation and we would fund HQ Global's operating losses at this location for a limited period of time. Due to deteriorating conditions in the local commercial real estate market, HQ Global subsequently determined that the tentative agreement was not in its best interest. HQ Global has now indicated to us that it intends to reject this lease unless its rent under this lease is reduced to current market rates. However, we entered into an agreement with HQ Global as of June 30, 2002 to fund operating losses at this location up to an aggregate amount of \$130,000 in exchange for HQ Global forbearing from rejecting this lease until September 15, 2002, or if it obtains from the bankruptcy court an extension of time within which to reject leases, November 1, 2002. Based on these changed circumstances, we have

## Edgar Filing: CARRAMERICA REALTY CORP - Form 10-Q

increased our provision for loss under this guarantee to \$6.9 million in the second quarter of 2002. This represents the amount we have determined to be our likely exposure under this guarantee as of June 30, 2002; however, there can be no assurance that we will not be required to further increase our provision or make cash payments related to this guarantee in future periods up to, in the aggregate, the full amount of the guarantee. We are currently exploring options to mitigate our exposure under this guarantee, including having the lease assigned to us and then subletting the space back to HQ Global or others. As of June 30, 2002, we had not made any payments under this guarantee.

We have investments in real estate joint ventures in which we hold 15%-50% interests. These investments are accounted for using the equity or cost method, as appropriate, and therefore, the assets and liabilities of the joint ventures are not included in our consolidated financial statements. Most of these joint ventures own and operate office buildings financed by non-recourse debt obligations that are secured only by the real estate and other assets of the joint ventures. We have no obligation to repay this debt and the lenders have no recourse to our other assets. As of June 30, 2002, we guaranteed \$34.5 million of debt related to joint ventures and \$5.2 million of debt related to a development project we have undertaken with a third party.

Our investments in these joint ventures are subject to risks not inherent in our majority owned properties, including:

- . Absence of exclusive control over the development, financing, leasing, management and other aspects of the project;
- . Possibility that our co-venturer or partner might:
  - . become bankrupt;
  - . have interests or goals that are inconsistent with ours;
  - . take action contrary to our instructions, requests or interests (including those related to our qualification as a REIT for tax purposes); or
  - . otherwise impede our objectives; and
- . Possibility that we, together with our partners, may be required to fund losses of the investee which losses would not necessarily appear on our consolidated financial statements (e.g. for cost method investments).

In addition to making investments in these ventures, we provide construction management, leasing, development and architectural and other services to them. We earned fees for these services of \$2.1 million for the three months ended June 30, 2002 and \$4.4 million for the three months ended June 30, 2001. For the six months ended June 30, 2002 and 2001, we earned fees of \$4.2 million and \$9.5 million, respectively, for these services.

We also earn fees for services provided to properties owned by third parties. Some members of our Board of Directors have ownership interests in these third party properties. During the second quarter of 2002 and 2001, we earned fees of \$0.4 million and \$0.2 million, respectively from properties in which members of our Board of Directors,

### Management's Discussion and Analysis

---

Mr. A. James Clark and Mr. Oliver Carr, had an interest. For the six months ended June 30, 2002 and 2001, we earned fees of \$0.9 million and \$0.9 million, respectively, from these properties.

## Edgar Filing: CARRAMERICA REALTY CORP - Form 10-Q

We purchase general contracting and other services from Clark Enterprises, Inc., an entity in which Mr. Clark is the majority stockholder. We, including our unconsolidated affiliates, paid \$6.9 million and \$8.0 million in the second quarter of 2002 and 2001, respectively, to Clark Enterprises, Inc. for these services. For the six months ended June 30, 2002 and 2001, we, including our unconsolidated affiliates, paid \$11.1 million and \$12.7 million, respectively, to Clark Enterprises, Inc. for these services. Substantially all of the payments, both quarter and year-to-date, are related to our unconsolidated affiliates.

### Funds From Operations

We believe that funds from operations is helpful to investors as a measure of the performance of an equity REIT. Based on our experience, funds from operations, along with information about cash flows from operating activities, investing activities and financing activities, provides investors with an indication of our ability to incur and service debt, to make capital expenditures and to fund other cash needs. Funds from operations is defined by the National Association of Real Estate Investment Trusts (NAREIT) as follows:

- .. Net income - computed in accordance with accounting principles generally accepted in the United States of America (GAAP);
- .. Less gains (or plus losses) from sales of operating properties and items that are classified as extraordinary items under GAAP;
- .. Plus depreciation and amortization of assets uniquely significant to the real estate industry;
- .. Plus or minus adjustments for unconsolidated partnerships and joint ventures (to reflect funds from operations on the same basis).

Our funds from operations may not be comparable to funds from operations reported by other REITs. These other REITs may not define the term in accordance with the current NAREIT definition or may interpret the current NAREIT definition differently than us. Funds from operations does not represent net income or cash flow generated from operating activities in accordance with GAAP. As such, it should not be considered an alternative to net income as an indication of our performance or to cash flows as a measure of our liquidity or our ability to make distributions.

The following table provides the calculation of our funds from operations for the periods presented:

(In thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2002	2001	2002	2001
Net income from continuing operations before minority interest	\$23,569	\$35,636	\$ 43,692	\$ 67,350
Adjustments to derive funds from operations:				
Add depreciation and amortization	33,266	31,751	69,169	64,450
Deduct:				
Minority interests' (non Unitholders) share of depreciation, amortization and net income	(290)	(219)	(516)	(500)
(Gain) loss on sale of assets and other provisions, net	(2,875)	22	(2,015)	(1,050)
Funds from operations before allocations to the minority Unitholders	53,670	67,190	110,330	130,250
Less: Funds from operations allocable to the				

## Edgar Filing: CARRAMERICA REALTY CORP - Form 10-Q

minority Unitholders	(4,670)	(4,507)	(8,991)	(8,34)
	-----	-----	-----	-----
Funds from operations allocable to CarrAmerica Realty Corporation	49,000	62,683	101,339	121,91
Less: Preferred stock dividends	(8,517)	(8,745)	(17,065)	(17,39)
	-----	-----	-----	-----
Funds from operations allocable to common shareholders	\$40,483	\$53,938	\$ 84,274	\$104,51
	=====	=====	=====	=====

23

### Management's Discussion and Analysis

---

#### FORWARD-LOOKING STATEMENTS

Certain statements contained herein constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995 (the "Reform Act"). Such forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our, and our affiliates, or the industry's actual results, performance, achievements or transactions to be materially different from any future results, performance, achievements or transactions expressed or implied by such forward-looking statements. Such factors include, among others, the following:

- . National and local economic, business and real estate conditions that will, among other things, affect:
  - . Demand for office properties
  - . The ability of the general economy to recover timely from the current economic conditions
  - . The availability and creditworthiness of tenants
  - . The level of lease rents
  - . The availability of financing for both tenants and us;
- . Adverse changes in the real estate markets, including, among other things:
  - . Competition with other companies, and
  - . Risks of real estate acquisition and development (including the failure of pending developments to be completed on time and within budget);
- . Possible charges or payments resulting from our guarantees of certain leases of HQ Global Workplaces, Inc;
- . Actions, strategies and performance of affiliates that we may not control or companies in which we have made investments;
- . Ability to obtain insurance at a reasonable cost;
- . Ability to maintain our status as a REIT for federal and state income tax purposes;
- . Governmental actions and initiatives; and
- . Environmental/safety requirements.

For further discussion of these and other factors that could impact our future results, performance, achievements or transactions, see the documents we file from time to time with the Securities and Exchange Commission, and in particular, the section titled "The Company - Risk Factors" in our Annual Report on Form 10-K.

24

Quantitative and Qualitative Disclosures About Market Risk

---

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We use derivative financial instruments from time to time to limit market risk. Interest rate protection agreements may be used to convert floating rate debt to a fixed rate basis, to convert fixed rate debt to a floating rate basis or to hedge anticipated financing transactions. We use derivative financial instruments only for hedging purposes, and not for speculation or trading purposes. On May 8, 2002, we entered into an interest rate swap with JP Morgan Chase and Bank of America, hedging \$150 million of senior unsecured notes due July 2004. The interest rate swap matures at the same time the notes are due. The swap qualifies as a fair value hedge. Net quarterly settlement payments are recognized as an increase or decrease to interest expense. The fair value of the interest rate swap is recognized on our balance sheet and the carrying value of the senior unsecured notes are increased or decreased by an offsetting amount. As of June 30, 2002, the fair value of the interest rate swap was approximately \$1.7 million. We recognized a credit to interest expense for the three months ended June 30, 2002 of approximately \$507,000 related to the swap. Any other significant changes in our market risk that have occurred since the filing of our Annual Report on Form 10-K for the year ended December 31, 2001 are summarized in the Liquidity and Capital Resources section of the Management's Discussion and Analysis of Financial Condition and Results of Operations.

25

Part II

OTHER INFORMATION

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

The 2002 annual meeting of stockholders was held on May 2, 2002. We solicited proxies for the meeting pursuant to Regulation 14 under the Securities Exchange Act of 1934, as amended; there was no solicitation in opposition to our management's nominees as listed in the proxy statement and all nominees were elected.

Proposal One: Election of Directors

- (a) 44,185,125 votes were cast for the election of Robert E. Torray as a Director; 646,068 votes were withheld.
- (b) 44,180,283 votes were cast for the election of Andrew F. Brimmer as a Director; 650,910 votes were withheld.
- (c) 44,183,073 votes were cast for the election of Oliver T. Carr as a Director; 648,120 votes were withheld.
- (d) 44,184,528 votes were cast for the election of Philip L. Hawkins as a Director; 646,665 votes were withheld.

The terms of Thomas A. Carr, A. James Clark, Timothy Howard and Wesley Williams, Jr. continued after the meeting and were not presented for re-election at that time.

Proposal Two: Amendments to Articles of Incorporation to remove special shareholder reference and to increase ownership limits.

Edgar Filing: CARRAMERICA REALTY CORP - Form 10-Q

FOR	AGAINST	ABSTAIN
44,685,947	94,757	50,489

Proposal Three: To recommend to instate the election of directors annually.

FOR	AGAINST	ABSTAIN
31,579,605	8,925,021	99,094

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

None.

(b) Reports on Form 8-K

Current Report on Form 8-K filed on April 19, 2002 regarding description of material U.S. federal income tax consequences relating to our taxation as a REIT and the ownership and disposition of our stock.

26

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CARRAMERICA REALTY CORPORATION

/s/ Stephen E. Riffée

-----  
Stephen E. Riffée, Chief Financial Officer  
(on behalf of the registrant and as the registrant's  
principal financial officer)

Date: August 14, 2002

27