

PENNSYLVANIA REAL ESTATE INVESTMENT TRUST  
Form 10-Q  
November 08, 2006

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**Form 10-Q**

**Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the quarterly period ended September 30, 2006**

**or**

**Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission File Number: 1-6300**

**PENNSYLVANIA REAL ESTATE INVESTMENT TRUST**

(Exact name of Registrant as specified in its charter)

**Pennsylvania**

(State or other jurisdiction of  
incorporation  
or organization)

**23-6216339**

(I.R.S. Employer Identification No.)

**200 South Broad Street**

**Philadelphia, PA**

(Address of principal executive  
offices)

**19102**

(Zip Code)

**Registrant's telephone number, including area code (215) 875-0700**

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 registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

Yes No

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

Common shares of beneficial interest, \$1.00 par value per share, outstanding at November 6, 2006: 36,875,609

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**PENNSYLVANIA REAL ESTATE INVESTMENT TRUST**

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(in thousands, except per share amounts)

(Unaudited)

	<b>September 30, 2006</b>	<b>December 31, 2005</b>
	<hr/>	<hr/>
<b>ASSETS:</b>		
INVESTMENTS IN REAL ESTATE, at cost:		
Operating properties	\$ 2,860,761	\$ 2,807,575
Construction in progress	192,190	55,368
Land held for development	5,616	5,616
	<hr/>	<hr/>
Total investments in real estate	3,058,567	2,868,559
Accumulated depreciation	(283,321 )	(220,788 )
	<hr/>	<hr/>
Net investments in real estate	2,775,246	2,647,771
INVESTMENTS IN PARTNERSHIPS, at equity	39,447	41,536
<b>OTHER ASSETS:</b>		
Cash and cash equivalents	17,134	21,642
Rents and other receivables (net of allowance for doubtful accounts of \$11,797 and \$10,671 at September 30, 2006 and December 31, 2005, respectively)	41,285	46,492
Intangible assets (net of accumulated amortization of \$100,416 and \$72,308 at September 30, 2006 and December 31, 2005, respectively)	145,969	173,594
Deferred costs and other assets, net	77,383	69,792
Assets held for sale	1,551	17,720
	<hr/>	<hr/>
Total assets	\$ 3,098,015	\$ 3,018,547
	<hr/>	<hr/>
<b>LIABILITIES:</b>		
Mortgage notes payable	\$ 1,578,598	\$ 1,332,066
Debt premium on mortgage notes payable	29,988	40,066
Credit Facility	277,000	342,500
Corporate notes payable		94,400
Tenants' deposits and deferred rents	12,894	13,298
Distributions in excess of partnership investments	64,971	13,353
Accrued expenses and other liabilities	100,060	69,435
Liabilities related to assets held for sale	48	18,233
	<hr/>	<hr/>

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Total liabilities	2,063,559	1,923,351
	<u>                    </u>	<u>                    </u>
MINORITY INTEREST:	103,671	118,320
	<u>                    </u>	<u>                    </u>
COMMITMENTS AND CONTINGENCIES (Note 9)		
SHAREHOLDERS' EQUITY:		
Shares of beneficial interest, \$1.00 par value per share; 100,000 shares authorized; issued and outstanding 36,865 shares at September 30, 2006 and 36,521 shares at December 31, 2005	36,865	36,521
Non-convertible senior preferred shares, 11% cumulative, \$.01 par value per share; 2,475 shares authorized, issued and outstanding at September 30, 2006 and December 31, 2005	25	25
Capital contributed in excess of par	913,185	899,439
Accumulated other comprehensive income	8,145	4,377
(Distributions in excess of net income) retained earnings	(27,435 )	36,514
	<u>                    </u>	<u>                    </u>
Total shareholders' equity	930,785	976,876
	<u>                    </u>	<u>                    </u>
Total liabilities, minority interest and shareholders' equity	\$ 3,098,015	\$ 3,018,547
	<u>                    </u>	<u>                    </u>

See accompanying notes to the unaudited consolidated financial statements.

[Back to Contents](#)**PENNSYLVANIA REAL ESTATE INVESTMENT TRUST****CONSOLIDATED STATEMENTS OF INCOME**

(in thousands of dollars)

(Unaudited)

	<b>For the Three Months Ended September 30,</b>		<b>For the Nine Months Ended September 30,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
<b>REVENUE:</b>				
Real estate revenues:				
Base rent	\$ 71,353	\$ 67,729	\$ 213,064	\$ 200,717
Expense reimbursements	34,394	32,299	100,973	93,614
Percentage rent	1,438	1,455	5,202	5,959
Lease termination revenue	439	176	2,583	1,265
Other real estate revenues	4,503	3,275	12,491	9,393
Total real estate revenues	112,127	104,934	334,313	310,948
Management company revenue	666	521	2,324	2,043
Interest and other income	566	293	1,452	738
Total revenues	113,359	105,748	338,089	313,729
<b>EXPENSES:</b>				
Property operating expenses:				
CAM and real estate taxes	(31,842 )	(28,734 )	(93,753 )	(85,094 )
Utilities	(7,137 )	(6,897 )	(18,734 )	(18,093 )
Other operating expenses	(6,748 )	(5,898 )	(19,200 )	(16,286 )
Total property operating expenses	(45,727 )	(41,529 )	(131,687 )	(119,473 )
Depreciation and amortization	(31,118 )	(27,550 )	(94,839 )	(80,801 )
Other expenses:				
General and administrative expenses	(9,668 )	(8,412 )	(30,187 )	(27,833 )
Executive separation			(3,985 )	
Income taxes	(142 )	(78 )	(383 )	(519 )
Total other expenses	(9,810 )	(8,490 )	(34,555 )	(28,352 )
Interest expense:				
Interest expense	(24,341 )	(21,056 )	(73,234 )	(61,118 )
Prepayment penalty		(803 )		(803 )
Total interest expense	(24,341 )	(21,859 )	(73,234 )	(61,921 )

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Total expenses	<u>(110,996 )</u>	<u>(99,428 )</u>	<u>(334,315 )</u>	<u>(290,547 )</u>
Income before equity in income of partnerships, gains on sales of interests in real estate, minority interest and discontinued operations	2,363	6,320	3,774	23,182
Equity in income of partnerships	1,044	1,808	4,075	5,426
Gains on sales of interests in real estate		5,024		5,661
Gains on sales of non-operating real estate	166	3,000	381	3,060
Income before minority interest and discontinued operations	<u>3,573</u>	<u>16,152</u>	<u>8,230</u>	<u>37,329</u>
Minority interest	(384 )	(1,818 )	(927 )	(4,308 )
Income from continuing operations	<u>3,189</u>	<u>14,334</u>	<u>7,303</u>	<u>33,021</u>
Discontinued operations:				
Operating results from discontinued operations	93	272	527	2,088
Gains on sales of discontinued operations	1,414	3,736	1,414	3,736
Minority interest	(152 )	(447 )	(196 )	(655 )
Income from discontinued operations	<u>1,355</u>	<u>3,561</u>	<u>1,745</u>	<u>5,169</u>
Net income	<u>4,544</u>	<u>17,895</u>	<u>9,048</u>	<u>38,190</u>
Dividends on preferred shares	(3,403 )	(3,403 )	(10,209 )	(10,209 )
Net income available (loss allocable) to common shareholders	<u>\$ 1,141</u>	<u>\$ 14,492</u>	<u>\$ (1,161 )</u>	<u>\$ 27,981</u>

See accompanying notes to the unaudited consolidated financial statements.

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(in thousands, except per share amounts)

(Unaudited)

	<b>For the Three Months Ended September 30,</b>		<b>For the Nine Months Ended September 30,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Income from continuing operations	\$3,189	\$14,334	\$7,303	\$33,021
Dividends on preferred shares	(3,403 )	(3,403 )	(10,209 )	(10,209 )
Income (loss) from continuing operations available (allocable) to common shareholders	(214 )	10,931	(2,906 )	22,812
Dividends on unvested restricted shares	(247 )	(265 )	(796 )	(770 )
Income (loss) from continuing operations used to calculate earnings per share	(461 )	10,666	(3,702 )	22,042
Minority interest in properties - continuing operations		42		127
Income (loss) from continuing operations used to calculate earnings per share - diluted	\$(461 )	\$10,708	\$(3,702 )	\$22,169
Income from discontinued operations	\$1,355	\$3,561	\$1,745	\$5,169
Basic earnings (loss) per share:				
Income (loss) from continuing operations	\$(0.01 )	\$0.29	\$(0.10 )	\$0.61
Income from discontinued operations	0.03	0.10	0.05	0.14
	\$0.02	\$0.39	\$(0.05 )	\$0.75
Diluted earnings (loss) per share:				
Income (loss) from continuing operations	\$(0.01 )	\$0.29	\$(0.10 )	\$0.60
Income from discontinued operations	0.03	0.10	0.05	0.14
	\$0.02	\$0.39	\$(0.05 )	\$0.74
Weighted-average shares outstanding - basic	36,282	36,149	36,189	36,049
Effect of common share equivalents		(1) 697		(1) 675
Weighted-average shares outstanding - diluted	36,282	36,846	36,189	36,724



- 
- (1) For the three and nine months ended September 30, 2006, there is a loss from continuing operations used to calculate earnings per share. The effect of common share equivalents would be antidilutive, therefore there is no impact of common share equivalents on the calculation of diluted loss per share for the three and nine months ended September 30, 2006.

See accompanying notes to the unaudited consolidated financial statements.

[Back to Contents](#)**PENNSYLVANIA REAL ESTATE INVESTMENT TRUST****CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in thousands of dollars)

(Unaudited)

	<b>For the Nine Months Ended September 30,</b>	
	<b>2006</b>	<b>2005</b>
Cash Flows from Operating Activities:		
Net income	\$9,048	\$38,190
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	68,132	58,280
Amortization	17,750	10,130
Straight-line rent adjustments	(2,119 )	(3,183 )
Provision for doubtful accounts	2,669	2,336
Amortization of deferred compensation	4,657	2,385
Minority interest	1,123	4,963
Gains on sales of interests in real estate	(1,794 )	(12,457 )
Change in assets and liabilities:		
Net change in other assets	1,160	(3,367 )
Net change in other liabilities	8,435	(1,299 )
Net cash provided by operating activities	<u>109,061</u>	<u>95,978</u>
Cash Flows from Investing Activities:		
Investments in consolidated real estate acquisitions, net of cash acquired	(34,969 )	(64,855 )
Investments in consolidated real estate improvements	(25,006 )	(28,509 )
Additions to construction in progress	(102,196 )	(46,112 )
Investments in partnerships	(1,519 )	(622 )
Increase in cash escrows	(961 )	(1,149 )
Capitalized leasing costs	(3,458 )	(2,563 )
Additions to leasehold improvements	(570 )	(2,725 )
Cash distributions from partnerships in excess of equity in income	55,454	1,360
Cash proceeds from sales of interests in partnerships		4,282
Cash proceeds from sales of consolidated real estate investments	9,039	3,940
Net cash used in investing activities	<u>(104,186 )</u>	<u>(136,953 )</u>
Cash Flows from Financing Activities:		
Principal installments on mortgage notes payable	(17,083 )	(14,008 )

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Proceeds from mortgage notes payable	246,500	266,000
Prepayment penalty on repayment of mortgage notes payable		(803 )
Repayment of mortgage notes payable		(147,529 )
Repayment of corporate notes payable	(94,400 )	
Net (repayment of) borrowing from Credit Facility	(65,500 )	5,000
Payment of deferred financing costs	(1,358 )	(1,675 )
Shares of beneficial interest issued	4,940	5,165
Shares of beneficial interest repurchased	(2,545 )	(3,048 )
Operating partnership units redeemed	(352 )	
Distributions paid to common shareholders	(62,789 )	(61,370 )
Distributions paid to preferred shareholders	(10,209 )	(10,209 )
Distributions paid to OP Unitholders and minority partners	(6,587 )	(7,638 )
	<u>          </u>	<u>          </u>
Net cash (used in) provided by financing activities	(9,383 )	29,885
	<u>          </u>	<u>          </u>
Net change in cash and cash equivalents	(4,508 )	(11,090 )
Cash and cash equivalents, beginning of period	21,642	40,044
	<u>          </u>	<u>          </u>
Cash and cash equivalents, end of period	\$17,134	\$28,954
	<u>          </u>	<u>          </u>

See accompanying notes to the unaudited consolidated financial statements.

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## PENNSYLVANIA REAL ESTATE INVESTMENT TRUST

### NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2006

(Unaudited)

#### 1. BASIS OF PRESENTATION:

Pennsylvania Real Estate Investment Trust ( PREIT or the Company ) prepared the consolidated financial statements pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles ( GAAP ) have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the included disclosures are adequate to make the information presented not misleading. The consolidated financial statements should be read in conjunction with the audited financial statements and the notes thereto included in PREIT's Annual Report on Form 10-K for the year ended December 31, 2005. In management's opinion, all adjustments, consisting only of normal recurring adjustments, necessary to present fairly the consolidated financial position of the Company and its subsidiaries and the consolidated results of its operations and its cash flows are included. The results of operations for the interim periods presented are not necessarily indicative of the results for the full year.

Pennsylvania Real Estate Investment Trust, a Pennsylvania business trust founded in 1960 and one of the first equity real estate investment trusts ( REITs ) in the United States, has a primary investment focus on retail shopping malls and power and strip centers located in the Mid-Atlantic region or in the eastern part of the United States. As of September 30, 2006, the Company's operating portfolio consisted of a total of 51 properties. The retail portion of the Company's portfolio contains 50 properties in 13 states and includes 39 shopping malls and 11 power and strip centers. The Company also owns one office property acquired as part of a mall acquisition that is classified as held for sale.

The Company's primary business is owning and operating shopping malls and power and strip centers. The Company evaluates operating results and allocates resources on a property-by-property basis and does not distinguish or evaluate its consolidated operations on a geographic basis. No individual property constitutes more than 10% of the Company's consolidated revenues or assets, and thus the individual properties have been aggregated into one reportable segment based upon their similarities with regard to the nature of the centers, the tenants and operational processes, as well as long-term financial performance. In addition, no single tenant accounts for 10% or more of the Company's consolidated revenue, and none of the shopping centers are located outside the United States.

The Company's interests in its properties are held through PREIT Associates, L.P. (the Operating Partnership ). The Company is the sole general partner of the Operating Partnership, and, as of September 30, 2006, the Company held a 90.3% interest in the Operating Partnership, and consolidated it for financial reporting purposes. The presentation of consolidated financial statements does not itself imply that the assets of any consolidated entity (including any special-purpose entity formed for a particular project) are available to pay the liabilities of any other consolidated entity, or that the liabilities of any consolidated entity (including any special-purpose entity formed for a particular project) are obligations of any other consolidated entity.

Pursuant to the terms of the partnership agreement of the Operating Partnership, each of the other limited partners of the Operating Partnership has the right to redeem his/her units of limited partnership interest in the Operating Partnership ( OP Units ) for cash or, at the election of the Company, the Company may acquire such OP Units for shares of the Company on a one-for-one basis, in some cases beginning one year following the respective issue date of the OP Units, and in other cases immediately.



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The Company provides its management, leasing and real estate development services through two companies: PREIT Services, LLC ( PREIT Services ), which generally develops and manages properties that the Company consolidates for financial reporting purposes, and PREIT-RUBIN, Inc. ( PRI ), which develops and manages properties that the Company does not consolidate for financial reporting purposes, including properties owned by partnerships in which the Company owns an interest. PREIT Services and PRI are consolidated. Because PRI is a taxable REIT subsidiary as defined by federal tax laws, it is capable of offering a broad range of services to tenants without jeopardizing the Company's continued qualification as a REIT under federal tax law.

Certain prior period amounts have been reclassified to conform with the current period presentation.

## **2. RECENT ACCOUNTING**

### **PRONOUNCEMENTS:**

#### **SFAS No. 157**

In September 2006, the FASB issued Statement of Financial Accounting Standards No.157, Fair Value Measurements ( SFAS No.157 ). SFAS No.157 establishes a new definition of fair value, provides guidance on how to measure fair value and establishes new disclosure requirements of assets and liabilities at their fair value measurements. SFAS No.157 is effective for fiscal years beginning after November 15, 2007. The Company has not determined whether the adoption of SFAS No. 157 will have any material effect on the Company's financial statements.

#### **SAB 108**

In September 2006, the SEC's staff issued Staff Accounting Bulletin ( SAB ) No. 108 Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements. This Bulletin provides guidance on the consideration of the effects of prior year misstatements in quantifying current year misstatements for the purpose of a materiality assessment. The guidance in SAB No. 108 must be applied to financial reports covering the first fiscal year ending after November 15, 2006. The Company is currently evaluating the guidance in this Bulletin.

#### **FIN 48**

In June 2006, the FASB issued FASB Interpretation No.48, Accounting for Uncertainty in Income Taxes ( FIN 48 ). FIN 48 addresses the recognition and measurement of tax-based benefits on the probability that they will be realized. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company has not determined whether the adoption of FIN 48 will have any material effect on the Company's financial statements.

#### **SFAS No. 123(R) and SAB No. 107**

In December 2004, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards No. 123(R), Share-Based Payment ( SFAS No. 123(R) ), which is a revision of SFAS No. 123 and supersedes APB Opinion No. 25. SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be valued at fair value on the date of grant, and to be expensed over the applicable vesting period. Pro forma disclosure of the income statement effects of share-based payments, which was permitted under SFAS No. 123, is no longer an alternative. As originally issued by the FASB, SFAS No. 123(R) was effective for all stock-based awards granted on or after July 1, 2005. In addition, companies must also recognize compensation expense related to any awards that were not fully vested as of July 1, 2005. In March 2005, the Securities and Exchange Commission ( SEC ) released Staff Accounting Bulletin No. 107 ( SAB No. 107 ), which provides guidance related to share-based payment arrangements for reporting companies. Also in March 2005, the SEC permitted reporting companies, and the Company elected, to defer adoption of SFAS No. 123(R) until the beginning of their

next fiscal year, which, for the Company, was January 1, 2006. Compensation expense for the unvested awards is measured based on the fair value of such awards previously calculated in connection with the development of the prior pro forma disclosures in accordance with the provisions of SFAS No. 123. The impact of the Company's adoption of SFAS No. 123(R) was not material.

### 3. REAL ESTATE ACTIVITIES:

Investments in real estate as of September 30, 2006 and December 31, 2005 were comprised of the following:

<b>(in thousands of dollars)</b>	<b>September 30, 2006</b>	<b>December 31, 2005</b>
Buildings, improvements and construction in progress	\$2,525,434	\$2,401,191
Land, including land held for development	533,133	467,368
Total investments in real estate	3,058,567	2,868,559
Accumulated depreciation	(283,321 )	(220,788 )
Net investments in real estate	\$2,775,246	\$2,647,771

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## Acquisitions

The Company records its acquisitions based on estimates of fair value as determined by management, based on available information and on assumptions of future performance. These allocations are subject to revisions, in accordance with GAAP, during the twelve-month periods following the closings of the acquisitions.

In December 2005, the Company acquired Woodland Mall in Grand Rapids, Michigan, for \$177.4 million. The Company funded the purchase price with two 90-day corporate notes totaling \$94.4 million having a weighted average interest rate of 6.85% and secured by letters of credit, \$80.5 million from its Credit Facility, and the remainder from its available working capital. These notes were subsequently repaid. Of the purchase price amount, \$6.1 million was allocated to the value of in-place leases, \$6.4 million was allocated to above-market leases and \$6.5 million was allocated to below-market leases.

In March 2005, the Company acquired Gadsden Mall in Gadsden, Alabama, for \$58.8 million. The Company funded the purchase price from its Credit Facility. Of the purchase price amount, \$7.8 million was allocated to the value of in-place leases, \$0.1 million was allocated to above-market leases and \$0.3 million was allocated to below-market leases. The acquisition included the nearby P&S Office Building, an office building that the Company considers to be non-strategic, and which the Company has classified as held for sale for financial reporting purposes.

In February 2005, the Company purchased the Cumberland Mall in Vineland, New Jersey and a vacant parcel adjacent to the mall. The total price paid for the mall and the adjacent parcel was \$59.5 million, including the assumption of \$47.7 million in mortgage debt. The Company paid the \$0.9 million purchase price of the adjacent parcel in cash, and the Company paid the remaining portion of the purchase price using 272,859 OP Units, which were valued at \$11.0 million, based on the average of the closing price of the Company's common shares on the ten consecutive trading days immediately before the closing date of the transaction. Of the purchase price amount, \$8.7 million was allocated to the value of in-place leases, \$0.2 million was allocated to above-market leases and \$0.3 million was allocated to below-market leases. The Company also recorded a debt premium of \$2.7 million in order to record Cumberland Mall's mortgage at fair value.

## Dispositions

In September 2006, the Company sold South Blanding Village, a strip center in Jacksonville, Florida, for \$7.5 million. The Company recorded a gain of \$1.4 million from this sale.

In June 2006, the Company recorded a \$0.2 million gain on the sale to Home Depot U.S.A., Inc. of a parcel located at the site of the Plaza at Magnolia in Florence, South Carolina, Plaza at Magnolia is currently under development. The parcel was subdivided from a larger tract.

In December 2005, the Company sold Festival at Exton in Exton, Pennsylvania for \$20.2 million. The Company recorded a gain of \$2.5 million from this sale.

In August 2005, the Company sold its four industrial properties (the Industrial Properties) for \$4.3 million. The Company recorded a gain of \$3.7 million from this sale.

In May 2005, pursuant to an option granted to the tenant in a 1994 ground lease agreement, the Company sold a parcel in Northeast Tower Center in Philadelphia, Pennsylvania containing a Home Depot store to Home Depot U.S.A, Inc. for \$12.5 million. The Company recorded a gain of \$0.6 million from this sale.

## Discontinued Operations



In accordance with Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets ( SFAS No.144 ), the Company has presented as discontinued operations the operating results of South Blanding Village, Festival at Exton, the Industrial Properties and the P&S Office Building.

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The following table summarizes revenue and expense information for the Company's discontinued operations:

(in thousands of dollars)	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2006	2005	2006	2005
Real estate revenues	\$266	\$652	\$916	\$3,317
Expenses:				
Property operating expenses	(132 )	(202 )	(245 )	(706 )
Depreciation and amortization	(41 )	(178 )	(144 )	(523 )
Total expenses	(173 )	(380 )	(389 )	(1,229 )
Operating results from discontinued operations	93	272	527	2,088
Gains on sales of discontinued operations	1,414	3,736	1,414	3,736
Minority interest	(152 )	(447 )	(196 )	(655 )
Income from discontinued operations	\$1,355	\$3,561	\$1,745	\$5,169

### Schuylkill Mall

During the first quarter of 2006, the Company reclassified Schuylkill Mall in Frackville, Pennsylvania for accounting purposes from held for sale to continuing operations. The Company reached this decision because the previously disclosed January 2006 agreement to sell the property was terminated, and the property no longer meets the conditions for an exception to the one-year classification requirement in SFAS No. 144. The Company intends to continue to actively market Schuylkill Mall for sale, but at this time, it cannot determine if or when a sale will be consummated. For balance sheet purposes, as of March 31, 2006, the assets and liabilities of Schuylkill Mall were reclassified from

assets held for sale and liabilities related to assets held for sale into the appropriate balance sheet captions. Because Schuylkill Mall was considered held for sale as of December 31, 2005, no reclassifications related to Schuylkill Mall were made as of that date. For income statement purposes, the results of operations for Schuylkill Mall are presented in continuing operations for all periods presented. In the first quarter of 2006, the Company recorded depreciation and amortization expense of \$2.8 million to reflect the depreciation and amortization during all of the period that Schuylkill Mall was classified as held for sale.

### **Capitalization of Costs**

Costs incurred for interest, real estate taxes and insurance that are directly related to development and redevelopment projects are capitalized only during periods in which activities necessary to prepare the property for its intended use are in progress. Costs incurred for such items after the property is substantially complete and ready for its intended use are charged to expense as incurred. The Company capitalizes a portion of development department employees compensation and benefits related to time spent involved in development and redevelopment projects.

The Company capitalizes payments made to obtain options to acquire real property. All other related costs that are incurred before acquisition of a property are capitalized if the acquisition of the property or if an option to acquire the property is probable. If the property is acquired, such costs are included in the amount recorded as the initial value of the asset. Capitalized pre-acquisition costs are charged to expense when it is probable that the property will not be acquired.

The Company capitalizes salaries, commissions and benefits related to time spent by leasing and legal department personnel involved in originating leases with third-party tenants.

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The following table summarizes the Company's capitalized salaries and benefits, real estate taxes and interest for the three and nine months ended September 30, 2006 and 2005:

(in thousands of dollars)	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2006	2005	2006	2005
Development and redevelopment:				
Salaries and benefits	\$723	\$459	\$1,707	\$1,243
Real estate taxes	\$1,089	\$175	\$1,328	\$391
Interest	\$2,799	\$795	\$6,154	\$1,690
Leasing:				
Salaries and benefits	\$1,115	\$801	\$3,458	\$2,563

#### 4. INVESTMENTS IN PARTNERSHIPS:

The following table presents summarized financial information of the equity investments in the Company's unconsolidated partnerships as of September 30, 2006 and December 31, 2005:

(in thousands of dollars)	September 30, 2006	December 31, 2005
<b>ASSETS:</b>		
Investments in real estate, at cost:		
Operating properties	\$ 328,346	\$314,704
Construction in progress	20,158	2,927
Total investments in real estate	348,504	317,631
Accumulated depreciation	(73,071 )	(62,554 )
Net investments in real estate	275,433	255,077
Cash and cash equivalents	5,157	4,830
Deferred costs, and other assets, net	27,293	37,634
Total assets	307,883	297,541
<b>LIABILITIES AND PARTNERS EQUITY:</b>		
Mortgage notes payable	(381,667 )	(269,000 )
Other liabilities	(18,181 )	(13,942 )
Total liabilities	(399,848 )	(282,942 )

Net equity (deficit)	<u>(91,965 )</u>	<u>14,599</u>
Partners' share	<u>45,491</u>	<u>(7,303 )</u>
Company's share	<u>(46,474 )</u>	<u>7,296</u>
Excess investment <sup>(1)</sup>	<u>14,076</u>	<u>13,701</u>
Advances	<u>6,874</u>	<u>7,186</u>
Net investments and advances	<u>\$ (25,524 )</u>	<u>\$28,183</u>
Investment in partnerships, at equity	<u>\$ 39,447</u>	<u>\$41,536</u>
Distributions in excess of partnership investments	<u>(64,971 )</u>	<u>(13,353 )</u>
Net investments and advances	<u>\$ (25,524 )</u>	<u>\$28,183</u>

- (1) Excess investment represents the unamortized difference of the Company's investment over the Company's share of the equity in the underlying net investment in the partnerships. The excess investment is amortized over the life of the properties within the partnership, and the amortization is included in Equity in income of partnerships.

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The following table summarizes the Company's share of equity in income of partnerships for the three and nine month periods ended September 30, 2006 and 2005:

(in thousands of dollars)	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2006	2005	2006	2005
Real estate revenues	\$16,771	\$13,690	\$49,707	\$42,697
Expenses:				
Property operating expenses	(4,739 )	(3,927 )	(14,643 )	(12,827 )
Interest expense	(6,696 )	(3,952 )	(16,746 )	(12,230 )
Depreciation and amortization	(3,304 )	(2,095 )	(10,347 )	(6,296 )
Total expenses	(14,739 )	(9,974 )	(41,736 )	(31,353 )
Net income	2,032	3,716	7,971	11,344
Partners' share	(997 )	(1,842 )	(3,928 )	(5,714 )
Company's share	1,035	1,874	4,043	5,630
Amortization of excess investment	9	(66 )	32	(204 )
Equity in income of partnerships	\$1,044	\$1,808	\$4,075	\$5,426

### Acquisition

In November 2005, the Company and its acquisition partner acquired Springfield Mall in Springfield, Pennsylvania, for \$103.5 million. To partially finance the acquisition costs, the Company and its acquisition partner obtained a \$76.5 million mortgage loan. The Company funded the remainder of its share of the purchase price with \$5.0 million in borrowings from its Credit Facility. Of the purchase price amount, \$2.9 million was allocated to the value of in-place leases, \$0.4 million was allocated to above-market leases and \$4.5 million was allocated to below-market leases.

### Dispositions

In July 2005, the Company sold its 40% interest in Laurel Mall in Hazleton, Pennsylvania. The total sales price of the mall was \$33.5 million, including assumed debt of \$22.6 million. The net cash proceeds to the Company were \$3.9 million. The Company recorded a gain of \$5.0 million in the third quarter of 2005 from this transaction.

In July 2005, a partnership in which the Company has a 50% interest sold the property on which the Christiana Power Center Phase II project would have been built to the Delaware Department of Transportation for \$17.0 million. The Company's share of the proceeds was \$9.5 million, representing a reimbursement for the \$5.0 million of costs and expenses it incurred previously in connection with the project and a gain on sale of non-operating real estate of \$3.0 million recognized in the third quarter of 2005 and \$1.5 million recognized in the fourth quarter of 2005.

### Mortgage Activity

In July 2006, the partnership that owns Lehigh Valley Mall in Whitehall, Pennsylvania entered into a \$150.0 million mortgage loan that is secured by Lehigh Valley Mall. The Company owns an indirect 50% ownership interest in this entity. The mortgage loan has an initial term of 12 months, during which monthly payments of interest only are required. There are three one-year extension options, provided that there is no event of default and that the borrower buys an interest rate cap for the term of any applicable extension. The loan bears interest at the one month LIBOR rate, reset monthly, plus a spread of 56 basis points. The initial interest rate was 5.905%. The loan may not be prepaid until August 2007. Thereafter, the loan may be prepaid in full on any monthly payment date. A portion of the proceeds of the loan were used to repay the previous first mortgage on the property, which had a balance of \$44.6 million. The Company received a distribution of \$51.9 million as its share of the remaining proceeds of this mortgage loan. The Company used this \$51.9 million to repay a portion of the outstanding balance under the Credit Facility and for working capital.

[Back to Contents](#)**5. CREDIT FACILITY:**

In March 2006, the Company entered into a second amendment to the terms of its Credit Facility. Pursuant to this amendment, the term of the Credit Facility has been extended to January 20, 2009, and the Company has an option to extend the term for an additional 14 months, provided that there is no event of default at that time. The previous termination date was November 20, 2007. The amendment also lowered the interest rate to between 0.95% and 1.40% per annum over LIBOR from 1.05% to 1.55% per annum over LIBOR, in both cases depending on the Company's leverage. The amendment reduced the capitalization rate used to calculate Gross Asset Value (as defined in the Credit Facility agreement) to 7.50% from 8.25%. The amendment also modified certain of the financial covenants of the Company in the Credit Facility agreement. The revised covenants reduce the minimum interest coverage and total debt ratios and allow for an increase in investments in partnerships.

**6. COMPREHENSIVE INCOME:**

The following table sets forth the computation of comprehensive income for the three and nine month periods ended September 30, 2006 and 2005:

(in thousands of dollars)	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2006	2005	2006	2005
Net income	\$4,544	\$17,895	\$9,048	\$38,190
Unrealized (loss) gain on derivatives	(19,788 )	9,722	3,741	4,564
Other comprehensive income	9	9	27	27
Total comprehensive (loss) income	\$(15,235 )	\$27,626	\$12,816	\$42,781

**7. CASH FLOW INFORMATION:**

Cash paid for interest was \$81.9 million (net of capitalized interest of \$6.2 million) and \$74.4 million (net of capitalized interest of \$1.7 million) for the nine months ended September 30, 2006 and 2005, respectively.

**Significant non-cash transactions**

In connection with the acquisition of Cumberland Mall in February 2005, the Company assumed mortgage loans of \$47.7 million and issued OP Units valued at \$11.0 million.

**8. RELATED PARTY TRANSACTIONS:****General**

PRI provides management, leasing and development services for 13 properties owned by partnerships and other entities in which certain officers or trustees of the Company and PRI or their immediate families and affiliated entities have indirect ownership interests. Total revenues earned by PRI for such services were \$0.2 million for each of the three month periods ended September 30, 2006 and 2005, and \$0.6 million for each of the nine month periods ended September 30, 2006 and 2005.

The Company leases its principal executive offices from Bellevue Associates (the Landlord), an entity in which certain officers/trustees of the Company have an interest. Total rent expense under this lease was \$0.4 million in each of the three month periods ended September 30, 2006 and 2005 and \$1.1 million in each of the nine month periods



ended September 30, 2006 and 2005, respectively. Ronald Rubin and George F. Rubin, collectively with members of their immediate families and affiliated entities, own approximately a 50% interest in the Landlord.

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The Company uses an airplane in which Ronald Rubin owns a fractional interest. The Company paid \$6,000 and \$45,000 for the three months ended September 30, 2006 and 2005, respectively, and \$17,000 and \$87,000 for the nine months ended September 30, 2006 and 2005 for flight time used by employees on Company-related business.

### **Executive Separation**

On March 1, 2006, the Company announced the retirement of Jonathan B. Weller, a Vice Chairman of the Company, effective April 15, 2006. In connection with Mr. Weller's retirement, on February 28, 2006, the Company entered into a Separation of Employment Agreement and General Release (the "Separation Agreement") with Mr. Weller. Pursuant to the Separation Agreement, Mr. Weller also retired from the Company's Board of Trustees, effective as of March 8, 2006, the date on which the Separation Agreement became irrevocable. The Company recorded an expense of \$4.0 million in connection with Mr. Weller's separation from the Company. The expense included executive separation cash payments made to Mr. Weller along with the acceleration of the deferred compensation expense associated with the unvested restricted shares and the estimated fair value of Mr. Weller's share of the 2005-2008 Outperformance Program ("OPP") (see Note 11). Mr. Weller exercised his outstanding options in August 2006. In connection with the Separation Agreement, the Amended and Restated Employment Agreement by and between the Company and Mr. Weller dated as of January 1, 2004 was terminated, effective as of March 8, 2006.

## **9. COMMITMENTS AND CONTINGENCIES:**

### **Development and Redevelopment Activities**

In connection with its current ground-up development and its redevelopment projects, the Company has made contractual commitments on some of these projects in the form of tenant allowances, lease termination fees and contracts with general contractors and other professional service providers. As of September 30, 2006, the remainder to be paid against such contractual and other commitments was \$55.7 million, which is expected to be financed through the Credit Facility or through short-term construction loans.

### **Tax Protection Agreements**

The Company has entered into tax protection agreements in connection with certain completed property acquisitions. Under these agreements, the Company has agreed not to dispose of certain protected properties in a taxable transaction until certain dates. In some cases, members of the Company's senior management and/or board of trustees are the beneficiaries of these agreements.

### **Other**

In connection with the merger (the "Merger") with Crown American Realty Trust ("Crown") that closed in November 2003, Crown's former operating partnership retained an 11% interest in the capital and 1% interest in the profits of two partnerships that own 12 shopping malls. This retained interest is subject to a put-call arrangement between Crown's former operating partnership and the Company. Pursuant to this arrangement, the Company has the right to require Crown's former operating partnership to contribute the retained interest to the Company following the 36<sup>th</sup> month after the closing of the Merger and Crown's former operating partnership has the right to contribute the retained interest to the Company following the 40<sup>th</sup> month after the closing of the Merger, in each case in exchange for 341,297 additional OP Units. Mark E. Pasquerilla, a trustee of the Company, and his affiliates control Crown's former operating partnership. The remaining partners of Crown's former operating partnership are entitled to receive distributions from the two partnerships that own the 12 shopping malls. The amount of the distributions is based on the distributions made by the Company's operating partnership and amounted to \$0.2 million in each of the three month periods ended September 30, 2006 and 2005, and \$0.6 million in each of the nine month periods ended September 30, 2006 and 2005.

In the normal course of business, the Company has become and may, in the future, become involved in legal actions relating to the ownership and operations of its properties and the properties it manages for third parties. In management's opinion, the resolution of any such pending legal actions is not expected to have a material adverse effect on the Company's consolidated financial position or results of operations.

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## **10. DERIVATIVES:**

In the normal course of business, the Company is exposed to financial market risks, including interest rate risk on its interest-bearing liabilities. The Company endeavors to limit these risks by following established risk management policies, procedures and strategies, including the use of financial instruments. The Company does not use financial instruments for trading or speculative purposes.

Financial instruments are recorded on the balance sheet as assets or liabilities based on each instrument's fair value. Changes in the fair value of financial instruments are recognized currently in earnings, unless the financial instrument meets the criteria for hedge accounting contained in Statement of Financial Accounting Standards No. 133,

Accounting for Derivative Instruments and Hedging Activities, as amended and interpreted (SFAS No. 133). If the financial instruments meet the criteria for a cash flow hedge, the gains and losses in the fair value of the financial instrument are deferred in other comprehensive income. Gains and losses on a cash flow hedge are reclassified into earnings when the forecasted transaction affects earnings. A contract that is designated as a hedge of an anticipated transaction which is no longer likely to occur is immediately recognized in earnings.

The anticipated transaction to be hedged must expose the Company to interest rate risk, and the hedging instrument must reduce the exposure and meet the requirements for hedge accounting under SFAS No. 133. The Company must formally designate the financial instrument as a hedge and document and assess the effectiveness of the hedge at inception and on a quarterly basis. Interest rate hedges that are designated as cash flow hedges hedge the future cash outflows on debt.

In March 2006, the Company entered into six forward-starting interest rate swap agreements that have a blended 10-year swap rate on a notional amount of \$150.0 million of 5.3562% settling no later than December 10, 2008.

In May 2005, the Company entered into three forward starting interest rate swap agreements that have a blended 10-year swap rate of 4.6858% on an aggregate notional amount of \$120.0 million settling no later than October 31, 2007. The Company also entered into seven forward starting interest rate swap agreements in May 2005 that have a blended 10-year swap rate of 4.8047% on an aggregate notional amount of \$250.0 million settling no later than December 10, 2008.

The Company entered into these swap agreements in order to hedge the expected interest payments associated with a portion of the Company's anticipated future issuances of long-term debt. The Company assessed the effectiveness of these swaps as hedges at inception and on September 30, 2006 and considers these swaps to be highly effective cash flow hedges under SFAS No. 133.

The Company's swaps will be settled in cash for the present value of the difference between the locked swap rate and the then-prevailing rate on or before the cash settlement dates corresponding to the dates of issuance of new long-term debt obligations. If the prevailing market interest rate exceeds the rate in the swap agreement, then the counterparty will make a payment to the Company. If it is lower, the Company will pay the counterparty. The settlement amounts will be amortized over the life of the debt as a yield adjustment.

To determine the fair values of derivative instruments prior to settlement, the Company uses a variety of methods and assumptions that are based on market conditions and risks existing at each balance sheet date. For the majority of financial instruments, including most derivatives, long-term investments and long-term debt, standard market conventions and techniques such as discounted cash flow analysis, option pricing models, replacement cost and termination cost are used to determine fair value. All methods of assessing fair value result in a general approximation of value, and there can be no assurance that the value in an actual transaction will be equivalent to the fair value set forth in the Company's financial statements.

The counterparties to these swap agreements are all major financial institutions and participants in the Credit Facility. The Company is potentially exposed to credit loss in the event of non-performance by these counterparties. However, because of their high credit ratings, the Company does not anticipate that any of the counterparties will fail to meet these obligations as they come due.

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The following table summarizes the terms and fair values of the Company's derivative financial instruments at September 30, 2006. The notional amounts at September 30, 2006 provide an indication of the extent of the Company's involvement in these instruments at that time, but do not represent exposure to credit, interest rate or market risks.

<b>Hedge Type</b>	<b>Notional Value</b>	<b>Fair Value at September 30, 2006</b>	<b>Fair Value at December 31, 2005</b>	<b>Interest Rate</b>	<b>Effective Date</b>	<b>Cash Settlement Date</b>
Agreements entered in May 2005:						
Swap-Cash Flow	\$50 million	\$1.7 million	1.0 million	4.6830%	July 31, 2007	October 31, 2007
Swap-Cash Flow	\$50 million	1.7 million	1.0 million	4.6820%	July 31, 2007	October 31, 2007
Swap-Cash Flow	\$20 million	0.7 million	0.4 million	4.7025%	July 31, 2007	October 31, 2007
Swap-Cash Flow	\$50 million	1.4 million	0.7 million	4.8120%	September 10, 2008	December 10, 2008
Swap-Cash Flow	\$50 million	1.5 million	0.7 million	4.7850%	September 10, 2008	December 10, 2008
Swap-Cash Flow	\$20 million	0.6 million	0.3 million	4.8135%	September 10, 2008	December 10, 2008
Swap-Cash Flow	\$45 million	1.2 million	0.6 million	4.8135%	September 10, 2008	December 10, 2008
Swap-Cash Flow	\$10 million	0.3 million	0.2 million	4.8400%	September 10, 2008	December 10, 2008
Swap-Cash Flow	\$50 million	1.5 million	0.7 million	4.7900%	September 10, 2008	December 10, 2008
Swap-Cash Flow	\$25 million	0.7 million	0.3 million	4.8220%	September 10, 2008	December 10, 2008
		<b>\$11.3 million</b>	<b>\$5.9 million</b>			

Agreements entered in March 2006:

Swap-Cash Flow	\$50 million	\$(0.5) million	N/A	5.3380%	September 10, 2008	December 10, 2008
Swap-Cash Flow	\$25 million	(0.2) million	N/A	5.3500%	September 10, 2008	December 10, 2008
Swap-Cash Flow	\$25 million	(0.3) million	N/A	5.3550%	September 10, 2008	December 10, 2008

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Swap-Cash Flow	\$20 million	(0.2) million	N/A	5.3750%	September 10, 2008	December 10, 2008
Swap-Cash Flow	\$15 million	(0.2) million	N/A	5.3810%	September 10, 2008	December 10, 2008
Swap-Cash Flow	\$15 million	(0.2) million	N/A	5.3810%	September 10, 2008	December 10, 2008
		<u>\$(1.6) million</u>	<u>N/A</u>			
Total		<u>\$9.7 million</u>	<u>\$5.9 million</u>			

As of September 30, 2006 and December 31, 2005, the estimated unrealized gain attributed to the cash flow hedges was \$9.7 million and \$5.9 million, respectively, and has been included in deferred costs and other assets and accumulated other comprehensive income in the accompanying consolidated balance sheets. The increase in the aggregate value from December 31, 2005 to September 30, 2006 is due to an increase in market interest rates during the first nine months of 2006, net of the impact of a decrease in market interest rates since the Company entered into the six hedging agreements in March 2006.

#### 11. STOCK-BASED COMPENSATION

In January 2005, the Company's Board of Trustees approved the 2005-2008 Outperformance Program (OPP), a performance-based incentive compensation program that is designed to pay a bonus (in the form of common shares of beneficial interest) if the Company's total return to shareholders (as defined in the OPP) exceeds certain thresholds over a four-year measurement period beginning on January 1, 2005. The Board of Trustees amended the OPP in March 2005. The Company measures and records compensation expense over the four year period in accordance with the provisions of SFAS 123(R). The Company accrued \$0.2 million of compensation expense related to the OPP for each of the three month periods ended September 30, 2006 and 2005, and \$1.0 million and \$0.7, respectively, for the nine month periods ended September 30, 2006 and 2005.

The Company's 2003 Equity Incentive Plan provides for the granting of, among other things, restricted share awards and options to purchase shares of beneficial interest to key employees and non-employee trustees of the Company. An additional five plans formerly provided for awards of restricted shares or options, under which options remain exercisable and some restricted shares remain outstanding and subject to restrictions. The Company has an additional plan that provides for grants of restricted shares to its non-employee trustees.

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In the nine months ended September 30, 2006, 132,761 restricted shares were issued to certain key employees and trustees as incentive compensation. The restricted shares were awarded at their fair value, which ranged from \$40.60 to \$41.75 per share. The restricted shares vest over periods of two to five years, and portions of the vested amounts vary based on the Company's performance. In the nine months ended September 30, 2006 and 2005 respectively, the Company also issued 1,750 and 3,050 service award shares at fair values of \$40.12 and \$42.825, respectively, for non-officer employees based on years of service. The Company recorded compensation expense of \$4.7 million and \$2.4 million in the nine months ended September 30, 2006 and 2005, respectively, related to all of these share awards and awards made in prior periods.

The following table presents the aggregate number of shares reserved for issuance and the number of shares that remained available for future awards under the two plans that had shares available as of September 30, 2006:

	<b>2003 Equity Incentive Plan</b>	<b>Restricted Share Plan For Nonemployee Trustees</b>
	<hr/>	<hr/>
Shares reserved for issuance	2,500,000	50,000
Available for grant at September 30, 2006	1,817,606	15,000

Options are granted at the fair market value of the underlying shares on the date of the grant. The options vest and are exercisable over periods determined by the Company, but in no event later than ten years from the grant date. Changes in options outstanding from January 1, 2006 through September 30, 2006 were as follows:

	<b>Weighted Average Exercise Price</b>	<b>2003 Equity Incentive Plan</b>	<b>1999 Equity Incentive Plan</b>	<b>1998 Stock Option Plan</b>	<b>1997 Stock Option Plan</b>	<b>1990 Employees Plan</b>	<b>1990 Nonemployee Trustee Plan</b>
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Options outstanding at January 1, 2006	\$23.70	18,974	100,000	35,300	201,000	26,105	49,875
Options exercised	22.92	(4,889 )		(4,750 )	(11,000 )	(25,605 )	
Options outstanding at September 30, 2006	<hr/> \$23.42	<hr/> 14,085	<hr/> 100,000	<hr/> 30,550	<hr/> 190,000	<hr/> 500	<hr/> 49,875

As of September 30, 2006, exercisable options to purchase 371,260 shares of beneficial interest with an aggregate exercise price of \$8.5 million (weighted average exercise price of \$22.98 per share) were outstanding.

As of September 30, 2006, an aggregate of outstanding exercisable and unexercisable options to purchase 385,010 shares of beneficial interest with a weighted average remaining contractual life of 2.5 years and an aggregate exercise price of \$9.0 million (weighted average exercise price of \$23.42 per share) were outstanding.



The following table summarizes information relating to all options outstanding as of September 30, 2006:

<b>Range of Exercise Prices (Per Share)</b>	<b>Options Outstanding as of September 30, 2006</b>		<b>Options Exercisable as of September 30, 2006</b>		
	<b>Number of Shares</b>	<b>Weighted Average Exercise Price (Per Share)</b>	<b>Number of Shares</b>	<b>Weighted Average Exercise Price (Per Share)</b>	<b>Weighted Average Remaining Life (years)</b>
\$13.00-\$18.99	110,736	\$17.73	110,736	\$17.73	4.0
\$19.00-\$28.99	254,274	24.95	253,024	24.93	1.4
\$29.00-\$38.99	20,000	35.62	7,500	34.83	7.4

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## **12. SUBSEQUENT EVENTS**

In October 2006, the mortgage note secured by Schuylkill Mall was modified to reduce the interest rate from 7.25% to 4.50% per annum. This mortgage note had a balance of \$16.5 million as of September 30, 2006 and matures on December 1, 2008.

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

The following analysis of our consolidated financial condition and results of operations should be read in conjunction with our unaudited consolidated financial statements and the notes thereto included elsewhere in this report.

### **OVERVIEW**

Pennsylvania Real Estate Investment Trust, a Pennsylvania business trust founded in 1960 and one of the first equity REITs in the United States, has a primary investment focus on retail shopping malls and power and strip centers located in the Mid-Atlantic region or in the eastern part of the United States. Our operating portfolio currently consists of 51 properties. The retail portion of our portfolio contains 50 properties in 13 states, and includes 39 shopping malls and 11 power and strip centers. We also own one office property acquired as part of a mall acquisition that we classify as held for sale. The retail properties have a total of 34.6 million square feet, of which we and partnerships or tenancy in common arrangements (collectively, "partnerships") in which we own an interest own 26.5 million square feet.

The retail properties that we consolidate for financial reporting purposes have 30.2 million square feet, of which we own 23.7 million square feet. Properties that are owned by unconsolidated partnerships with third parties (see below) have 4.4 million square feet, of which 2.8 million square feet are owned by such partnerships.

Our primary business is owning and operating shopping malls and power and strip centers. We evaluate operating results and allocate resources on a property-by-property basis, and do not distinguish or evaluate our consolidated operations on a geographic basis. No individual property constitutes more than 10% of our consolidated revenue or assets, and thus the individual properties have been aggregated into one reportable segment based upon their similarities with regard to the nature of our properties and the nature of our tenants and operational processes, as well as long-term financial performance. In addition, no single tenant accounts for 10% or more of our consolidated revenue, and none of our properties are located outside the United States.

We hold our interests in our portfolio of properties through our operating partnership, PREIT Associates, L.P. ("PREIT Associates"). We are the sole general partner of PREIT Associates and, as of September 30, 2006, held a 90.3% controlling interest in PREIT Associates. We consolidate PREIT Associates for financial reporting purposes. We hold our investments in seven of the 50 operating retail properties in our portfolio through unconsolidated partnerships with third parties. We hold a non-controlling 50% interest in each unconsolidated partnership, and account for such partnerships using the equity method of accounting. We do not control any of these equity method investees for the following reasons:

Except for two properties that we co-manage with our partner, all of the other entities are managed on a day-to-day basis by one of our other partners as the managing general partner in each of the respective partnerships. In the case of the co-managed properties, all decisions in the ordinary course of business are made jointly.

The managing general partner is responsible for establishing the operating and capital decisions of the partnership, including budgets, in the ordinary course of business.

All major decisions of each partnership, such as the sale, refinancing, expansion or rehabilitation of the property, require the approval of all partners.

Voting rights and the sharing of profits and losses are generally in proportion to the ownership percentages of each partner.

We record the earnings from the unconsolidated partnerships using the equity method of accounting under the income statement caption entitled "Equity in income of partnerships" rather than consolidating the results of the unconsolidated partnerships with our results. Our investments in these entities are recorded in the balance sheet caption entitled "Investment in partnerships, at equity." In the case of deficit investment balances, such amounts are recorded in

Distributions in excess of partnership investments.

For further information regarding our unconsolidated partnerships, see Note 4 to our unaudited consolidated financial statements.

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We provide our management, leasing and development services through PREIT Services, LLC, which generally develops and manages properties that we consolidate for financial reporting purposes, and PREIT-RUBIN, Inc. ( PRI ), which generally develops and manages properties that we own interests in through partnerships with third parties and properties that are owned by third parties in which we do not have an interest. One of our long-term objectives is to obtain managerial control of as many of our assets as possible. Due to the nature of our existing partnership arrangements, we cannot anticipate when this objective will be achieved, if at all.

Our revenues consist primarily of fixed rental income, additional rent in the form of expense reimbursements, and percentage rents (rents that are based on a percentage of our tenants' sales or a percentage of sales in excess of thresholds that are specified in the leases) derived from our income producing retail properties. We also receive income from our real estate partnership investments and from the management and leasing services PRI provides.

Our net income decreased by \$13.4 million, or 75%, to \$4.5 million for the three months ended September 30, 2006 from \$17.9 million for the three months ended September 30, 2005. Our net income decreased by \$29.2 million, or 76% to \$9.0 million for the nine months ended September 30, 2006 from \$38.2 million for the nine months ended September 30, 2005. Net income available to common shareholders for the third quarter of 2006 was \$1.1 million, or \$0.02 per diluted share. In the third quarter of 2005, net income available to common shareholders was \$14.5 million, or \$0.39 per diluted share. For the nine months ended September 30, 2006, net loss allocable to common shareholders was \$1.2 million or (\$0.05) per diluted share, compared to net income available to common shareholders of \$28.0 million or \$0.74 per diluted share, in the nine months ended September 30, 2005.

The results of operations for the three and nine months ended September 30, 2006 and 2005 reflect changes due to the acquisition and disposition of real estate properties since July 1, 2005 and January 1, 2005, respectively. In 2005, we acquired three retail properties and a 50% ownership interest in one additional retail property; we disposed of four industrial properties, one strip center and our partnership interest in one additional retail property. Aggregate gains on the sales of real estate and interests in real estate were \$1.6 million and \$11.8 million for the three months ended September 30, 2006 and 2005, respectively, and \$1.8 million and \$12.5 million for the nine months ended September 30, 2006 and 2005, respectively. Our results for the three and nine months ended September 30, 2006 were also significantly affected by ongoing redevelopment initiatives that were in various stages at 13 of our 39 consolidated mall properties. While we might undertake a redevelopment at a given property to maximize the long term performance of the property, in the short term, the operations and performance of the property, as measured by occupancy and net operating income, might be negatively affected. Tenants will be relocated or leave as space for the redevelopment is aggregated, which affects tenant sales and rental rates. Some space at a property may be taken out of retail use during the redevelopment, and some space may only be made available for short periods of time pending scheduled renovation. Furthermore, our results for the nine months ended September 30, 2006 were affected by the \$4.0 million of separation expenses associated with the retirement of a Vice Chairman of the Company, as well as \$2.8 million of depreciation and amortization expense recorded during the period in connection with the reclassification of Schuylkill Mall from held for sale to continuing operations reflecting depreciation and amortization during all of the period that Schuylkill Mall was classified as held for sale.

## **ACQUISITIONS, DISPOSITIONS AND DEVELOPMENT ACTIVITIES**

The Company records its acquisitions based on estimates of fair value as determined by management, using information available and based on assumptions of future performance. These allocations are subject to revisions, in accordance with GAAP, during the twelve-month periods following the closings of the respective acquisitions.

We are actively involved in pursuing and evaluating additional acquisition opportunities. Our evaluation includes an analysis of whether the properties meet the investment criteria we apply, given economic, market and other circumstances.

Acquisitions

In December 2005, we acquired Woodland Mall in Grand Rapids, Michigan, with 1.2 million square feet, for \$177.4 million. We funded the purchase price with two 90-day corporate notes totaling \$94.4 million having a weighted average interest rate of 6.85% and secured by letters of credit, \$80.5 million from our Credit Facility, and the remainder from our available working capital. We obtained long term financing on this property in March 2006 and used these funds to pay off the corporate notes of \$94.4 million. Of the purchase price amount, \$6.1 million was allocated to the value of in-place leases, \$6.4 million was allocated to above-market leases and \$6.5 million was allocated to below-market leases.

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In November 2005, a partnership in which we own a 50% interest acquired Springfield Mall in Springfield, Pennsylvania, with 0.6 million square feet, for \$103.5 million. To partially finance the acquisition costs, we and our partner obtained a \$76.5 million mortgage loan. We funded the remainder of our share of the purchase price with \$5.0 million in borrowings from our Credit Facility. Of the purchase price amount, \$2.7 million was allocated to the value of in-place leases, \$0.4 million was allocated to above-market leases and \$4.5 million was allocated to below-market leases.

In March 2005, we acquired Gadsden Mall in Gadsden, Alabama, with 0.5 million square feet, for \$58.8 million. We funded the purchase price from our Credit Facility. Of the purchase price amount, \$7.8 million was allocated to the value of in-place leases, \$0.1 million was allocated to above-market leases and \$0.3 million was allocated to below-market leases. The acquisition included the nearby P&S Office Building, a 40,000 square foot office building that we consider to be non-strategic, and which we have classified as held for sale for financial reporting purposes.

In February 2005, we purchased the 0.9 million square foot Cumberland Mall in Vineland, New Jersey and a vacant 1.7 acre parcel adjacent to the mall. The total price paid for the mall and the parcel was \$59.5 million, including the assumption of \$47.7 million in mortgage debt. We paid the \$0.9 million purchase price of the adjacent parcel in cash. We paid the remaining portion of the purchase price for the mall using 272,859 units in PREIT Associates ( OP Units ), which were valued at \$11.0 million. Of the purchase price amount, \$8.7 million was allocated to the value of in-place leases, \$0.2 million was allocated to above-market leases and \$0.3 million was allocated to below-market leases. We also recorded a debt premium of \$2.7 million in order to record Cumberland Mall's mortgage at fair value.

Dispositions

In September 2006, we sold South Blanding Village, a strip center in Jacksonville, Florida, for \$7.5 million. We recorded a gain of \$1.4 million from this sale.

In June 2006, we recorded a \$0.2 million gain on the sale of an 11 acre parcel located at the site of the Plaza at Magnolia in Florence, South Carolina to Home Depot U.S.A., Inc. Plaza at Magnolia is currently under development. The parcel was subdivided from a 25 acre tract.

In December 2005, we sold Festival at Exton in Exton, Pennsylvania for \$20.2 million. We recorded a gain of \$2.5 million from this sale.

In August 2005, we sold our four industrial properties (the Industrial Properties ) for \$4.3 million. We recorded a gain of \$3.7 million from this transaction.

In July 2005, a partnership in which we have a 50% interest sold the property on which the Christiana Power Center Phase II project would have been built to the Delaware Department of Transportation for \$17.0 million. Our share of the proceeds was \$9.5 million, representing a reimbursement for the \$5.0 million of costs and expenses incurred previously in connection with the project and a gain on the sale of non-operating real estate of \$4.5 million, \$3.0 million of which was recognized in the third quarter of 2005, and \$1.5 million of which was recognized in the fourth quarter of 2005.

In July 2005, we sold our 40% interest in Laurel Mall in Hazleton, Pennsylvania to Laurel Mall, LLC. The total sales price of the mall was \$33.5 million, including assumed debt of \$22.6 million. Our net cash proceeds were \$3.9 million. We recorded a gain of \$5.0 million from this transaction.

In May 2005, pursuant to an option granted to the tenant in a 1994 ground lease agreement, we sold a 13.5 acre parcel in Northeast Tower Center in Philadelphia, Pennsylvania containing a Home Depot store to Home Depot U.S.A., Inc.

for \$12.5 million. We recorded a gain of \$0.6 million on the sale of this parcel.

Development and Redevelopment

We are engaged in the ground-up development of eight retail and other mixed-use projects that we believe meet the financial hurdles that we apply, given economic, market and other circumstances. As of September 30, 2006, we had incurred \$98.9 million of costs related to these projects. The costs identified to date to complete these ground-up projects are expected to be \$237.8 million in the aggregate (including costs already incurred), and excluding Springhills (Gainesville, Florida) and Pavilion at Market East (Philadelphia, Pennsylvania) projects because details of those projects and the related amounts have not been determined. In each case, we will evaluate the financing opportunities available to us at the time a project requires funding. In cases where the project is undertaken with a partner, our flexibility in funding the project might be governed by the partnership agreement or the covenants contained in our Credit Facility, which limit our involvement in such projects.



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We generally seek to develop these projects in areas that we believe evidence the likelihood of supporting additional retail development and have desirable population or income trends, and where we believe the projects have the potential for strong competitive positions. We will consider other uses of a property that would have synergies with our retail development and redevelopment based on several factors, including local demographics, market demand for other uses such as residential and office, and applicable land use regulations. We generally have several development projects under way at one time. These projects are typically in various stages of the development process. We manage all aspects of these undertakings, including market and trade area research, site selection, acquisition, preliminary development work, construction and leasing. We monitor our developments closely, including costs and tenant interest.

<b>Development Project</b>	<b>Estimated Project Cost</b>	<b>Invested as of September 30, 2006</b>	<b>Expected Initial Occupancy Date</b>
The Plaza at Magnolia	\$11.3 million	\$6.8 million	Third Quarter 2006
Lacey Retail Center	49.5 million	19.0 million	Third Quarter 2007
New River Valley Retail Center	27.9 million	4.9 million	Fourth Quarter 2007
Monroe Marketplace	57.0 million	5.5 million	Third Quarter 2008
New Garden Town Center	82.1 million	34.0 million	Third Quarter 2009
Valley View Downs	10.0 million	1.3 million	To Be Determined
Springhills	To Be Determined	25.5 million	To Be Determined
Pavilion at Market East	Determined	1.9 million	To Be Determined
		98.9	
		\$million	

We are engaged in the redevelopment of 13 of our consolidated properties and one of our unconsolidated properties and expect to increase the number of such projects in the future. These projects may include the introduction of multifamily, office or other uses to our properties.

The following tables summarize our intended investment for redevelopment and ground-up development projects:

<b>Redevelopment Project</b>	<b>Estimated Project Cost</b>	<b>Invested as of September 30, 2006</b>	<b>Expected Initial Occupancy Date</b>
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Capital City Mall	\$12.8 million	\$9.7 million	Fourth Quarter 2005
Patrick Henry Mall	29.3 million	24.8 million	Fourth Quarter 2005
Cumberland Mall	5.3 million	4.0 million	First Quarter 2006
New River Valley Mall	25.7 million	10.7 million	First Quarter 2006
Lycoming Mall	18.1 million	12.3 million	Second Quarter 2006
Francis Scott Key Mall	4.8 million	3.0 million	Third Quarter 2006
Valley View Mall	4.7 million	3.4 million	Fourth Quarter 2006
Magnolia Mall	16.8 million	1.7 million	Second Quarter 2007
Beaver Valley Mall	9.2 million	1.3 million	Third Quarter 2007
Lehigh Valley Mall <sup>(1)</sup>	20.3 million	0.4 million	Third Quarter 2007
Plymouth Meeting Mall	83.9 million	21.0 million	Fourth Quarter 2007
Willow Grove Park	54.4 million	18.2 million	First Quarter 2008
Voorhees Town Center	60.7 million	2.8 million	To Be Determined
Cherry Hill Mall	To Be Determined	19.6 million	To Be Determined
		132.9 \$million	

(1) This property is unconsolidated. The amounts shown represent our share.

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## **OFF BALANCE SHEET ARRANGEMENTS**

We have no material off-balance sheet items other than the partnerships described in Note 4 to the consolidated financial statements and in the Overview section above. We have, however, entered into tax protection agreements in connection with certain property acquisitions. Under these agreements, we have agreed not to dispose of certain protected properties in a taxable transaction until certain dates. In some cases, members of our senior management and/or board of trustees are the beneficiaries of these agreements.

## **RELATED PARTY TRANSACTIONS**

### General

PRI provides management, leasing and development services for 13 properties owned by partnerships and other entities in which certain officers or trustees of us and PRI or their immediate families and affiliated entities have indirect ownership interests. Total revenues earned by PRI for such services were \$0.2 million for each of the three month periods ended September 30, 2006 and 2005, and \$0.6 million for each of the nine month periods ended September 30, 2006 and 2005.

We leased our principal executive offices from Bellevue Associates (the Landlord), an entity in which certain of our officers/trustees have an interest. Total rent expense under this lease was \$0.4 million in each of the three month periods ended September 30, 2006 and 2005 and \$1.1 million in each of the nine month periods ended September 30, 2006 and 2005, respectively. Ronald Rubin and George F. Rubin, collectively with members of their immediate families and affiliated entities, own approximately a 50% interest in the Landlord.

We used an airplane in which Ronald Rubin owns a fractional interest. We paid \$6,000 and \$45,000 for the three months ended September 30, 2006 and 2005, respectively, and \$17,000 and \$87,000 for the nine months ended September 30, 2006 and 2005 for flight time used by employees on Company-related business.

### Executive Separation

On March 1, 2006, we announced the retirement of Jonathan B. Weller, a Vice Chairman of the Company, effective April 15, 2006. In connection with Mr. Weller's retirement, on February 28, 2006, we entered into a Separation of Employment Agreement and General Release (the Separation Agreement) with Mr. Weller. Pursuant to the Separation Agreement, Mr. Weller also retired from our Board of Trustees, effective as of March 8, 2006, the date on which the Separation Agreement became irrevocable. We recorded an expense of \$4.0 million in connection with Mr. Weller's separation from the Company. The expense included executive separation cash payments made to Mr. Weller along with the acceleration of the deferred compensation expense associated with the unvested restricted shares and the estimated fair value of Mr. Weller's share of the 2005-2008 Outperformance Program. Mr. Weller exercised his outstanding options in August, and he will remain eligible to receive performance shares under our 2005-2008 Outperformance Program. In connection with the Separation Agreement, the Amended and Restated Employment Agreement by and between us and Mr. Weller dated as of January 1, 2004 was terminated, effective as of March 8, 2006, the date on which the Separation Agreement became irrevocable.

## **CRITICAL ACCOUNTING POLICIES**

Critical accounting policies are those that require the application of management's most difficult, subjective, or complex judgments, often because of the need to make estimates about the effect of matters that are inherently uncertain and that may change in subsequent periods. In preparing the consolidated financial statements, management has made estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the

financial statements, and the reported amounts of revenues and expenses during the reporting periods. In preparing the financial statements, management has utilized available information, including our past history, industry standards and the current economic environment, among other factors, in forming its estimates and judgments, giving due consideration to materiality. Actual results may differ from these estimates. In addition, other companies may utilize different estimates, which may impact the comparability of our results of operations to those of companies in similar businesses.

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Our management makes complex or subjective assumptions and judgments with respect to applying its critical accounting policies. In making these judgments and assumptions, management considers, among other factors:

events and changes in property, market and economic conditions;  
 estimated future cash flows from property operations; and  
 the risk of loss on specific accounts or amounts.

The estimates and assumptions made by management in applying critical accounting policies have not changed materially during 2006 and 2005, and none of these estimates or assumptions have proven to be materially incorrect or resulted in our recording any significant adjustments relating to prior periods. We will continue to monitor the key factors underlying our estimates and judgments, but no change is currently expected. See our Annual Report on Form 10-K for a summary of the accounting policies that management believes are critical to the preparation of the consolidated financial statements.

## RESULTS OF OPERATIONS

### Three and Nine Months Ended September 30, 2006 and 2005

The following information summarizes our results of operations for the three month periods ended September 30, 2006 and 2005.

<b>(in thousands of dollars)</b>	<b>Three Months Ended September 30, 2006</b>	<b>Three Months Ended September 30, 2005</b>	<b>% Change 2005 to 2006</b>	
Real estate revenues	\$ 112,127	\$ 104,934	7	%
Property operating expenses	(45,727 )	(41,529 )	10	%
Management company revenue	666	521	28	%
Interest and other income	566	293	93	%
Other expenses and income taxes	(9,810 )	(8,490 )	16	%
Interest expense	(24,341 )	(21,859 )	11	%
Depreciation and amortization	(31,118 )	(27,550 )	13	%
Equity in income of partnerships	1,044	1,808	(42	%)
Gains on sales of interests in real estate		5,024	(100	%)
Gains on sales of non-operating real estate	166	3,000	(94	%)
Minority interest	(384 )	(1,818 )	(79	%)
Income from continuing operations	3,189	14,334	(78	%)
Income from discontinued operations	1,355	3,561	(62	%)
Net income	\$ 4,544	\$ 17,895	(75	%)

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The following information summarizes our results of operations for the nine month periods ended September 30, 2006 and 2005.

(in thousands of dollars)	<b>Nine Months Ended September 30, 2006</b>	<b>Nine Months Ended September 30, 2005</b>	<b>% Change 2005 to 2006</b>	
Real estate revenues	\$ 334,313	\$ 310,948	8	%
Property operating expenses	(131,687 )	(119,473 )	10	%
Management company revenue	2,324	2,044	14	%
Interest and other income	1,452	737	97	%
Other expenses and income taxes	(30,570 )	(28,352 )	8	%
Executive separation	(3,985 )			
Interest expense	(73,234 )	(61,921 )	18	%
Depreciation and amortization	(94,839 )	(80,801 )	17	%
Equity in income of partnerships	4,075	5,426	(25	%)
Gains on sales of interests in real estate		5,661	(100	%)
Gains on sales of non-operating real estate	381	3,060	(88	%)
Minority interest	(927 )	(4,308 )	(78	%)
Income from continuing operations	7,303	33,021	(78	%)
Income from discontinued operations	1,745	5,169	(66	%)
Net income	\$ 9,048	\$ 38,190	(76	%)

The amounts reflected as income from continuing operations in the tables above reflect income from properties wholly-owned by us or owned by partnerships that we consolidate for financial reporting purposes, with the exception of the properties that are classified as discontinued operations. Our unconsolidated partnerships are presented using the equity method of accounting in the line item Equity in income of partnerships.

The following table sets forth information regarding occupancy in the Company's retail portfolio as of September 30, 2006.

	<b>Occupancy as of September 30,</b>		
	<b>2006</b>	<b>2005</b>	
Operating portfolio weighted average:			
Total including anchors	89.8	%91.8	%

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Excluding anchors	87.3	% 87.5	%
Enclosed malls weighted average:			
Total including anchors	88.7	% 90.9	%
Excluding anchors	85.7	% 85.9	%
Power and strip centers weighted average	97.6	% 97.3	%
Real Estate Revenues			

Real estate revenues increased by \$7.2 million, or 7%, in the three months ended September 30, 2006 as compared to the three months ended September 30, 2005, primarily due to an increase of \$5.9 million from Woodland Mall, which was acquired in December 2005. Real estate revenues from properties that were owned by the Company prior to July 1, 2005 increased by \$1.3 million, or 1%, primarily due to increases of \$0.2 million in base rent, \$0.3 million in lease termination revenue and \$1.0 million in other revenues, offset by a \$0.2 million decrease in expense reimbursements.

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In connection with our redevelopment efforts, base rent at Echelon Mall decreased by \$0.3 million in the three months ended September 30, 2006 as compared to the three months ended September 30, 2005, largely due to the effects of the early stages of the redevelopment initiative on in-line occupancy (48.2% as of September 30, 2006 and 53.0% as of September 30, 2005). Base rent at the remaining properties owned by the Company prior to July 1, 2005 increased by \$0.5 million, or 1%, in the three months ending September 30, 2006. This increase is primarily due to higher average base rent partially offset by lower occupancy.

Many of our malls experienced a decrease in expense reimbursements in 2006 as compared to 2005. While this trend is not limited to the redevelopment properties, the recovery rates at these properties are approximately 4% lower than at our other malls. Our properties are experiencing a trend towards more gross leases, leases that pay a percentage of sales in lieu of minimum rent and rental concessions made to tenants impacted by the redevelopment activities. We expect the lower recovery rates at the redevelopment assets to improve as construction is completed, tenants take occupancy and our leasing leverage improves.

For the three months ended September 30, 2006, other revenues increased primarily due to the conversion of eight mall merchants associations to marketing funds effective January 1, 2006. These conversions resulted in increased marketing revenues of \$0.5 million compared to the three months ended September 30, 2005. These increased marketing revenues were offset by a \$0.5 million increase in marketing expenses. Other revenue also increased because ancillary revenues increased \$0.2 million and miscellaneous revenues increased \$0.2 million, primarily due to a bankruptcy court distribution related to one tenant that closed five stores during 2005. Lease termination revenue was higher during the three months ended September 30, 2006 primarily due to \$0.2 million received from one tenant.

Real estate revenues increased by \$23.4 million, or 8%, in the first nine months of 2006 as compared to the first nine months of 2005, primarily due to an increase of \$19.8 million from properties acquired in 2005, including Woodland Mall (\$17.3 million), Gadsden Mall (\$1.4 million) and Cumberland Mall (\$1.1 million). Real estate revenues from properties that were owned by the Company prior to January 1, 2005 increased by \$3.6 million, or 1%, primarily due to increases of \$0.5 million in base rent, \$1.3 million in lease termination revenue and \$2.6 million in other revenues, offset by a \$0.8 million decrease in percentage rent.

In connection with our redevelopment efforts, base rent at Echelon Mall decreased by \$1.3 million in the first nine months of 2006 as compared to the first nine months of 2005, largely due to the effects of the early stages of the redevelopment initiative on in-line occupancy, as noted above. Base rent was also affected by the May 2005 sale of the Home Depot parcel at Northeast Tower Center, resulting in real estate revenues that were \$0.4 million lower in the nine months ended September 30, 2006 as compared to the nine months ended September 30, 2005. Base rent at the remaining properties owned by the Company prior to January 1, 2005 increased by \$2.2 million, or 1%, in the nine months ending September 30, 2006. This increase is primarily due to higher average base rent, partially offset by lower occupancy.

For the nine months ended September 30, 2006, other revenues increased primarily due to the conversion of eight mall merchants associations to marketing funds effective January 1, 2006. These conversions resulted in increased marketing revenues of \$1.5 million compared to the nine months ended September 30, 2005. These increased marketing revenues were offset by a \$1.5 million increase in marketing expenses. Other revenue also increased because ancillary revenues increased \$0.7 million. Lease termination revenue increased in the first nine months of 2006 primarily due to \$1.2 million received from two tenants. Percentage rent was lower during the nine months ended September 30, 2006 primarily because results for the second quarter of 2005 included \$0.4 million of percentage rent revenues billed as a result of sales audits.

Property Operating Expenses



Property operating expenses increased by \$4.2 million, or 10%, in the three months ended September 30, 2006 as compared to the three months ended September 30, 2005, primarily due to an increase of \$2.5 million from Woodland Mall. Property operating expenses for properties that we owned prior to July 1, 2005 increased by \$1.7 million, or 4%, primarily due to a \$1.4 million increase in common area maintenance expense, a \$0.2 million increase in insurance expense and a \$0.6 million increase in other operating expenses, offset by a \$0.5 million decrease in real estate tax expense.

The increase in other operating expenses resulted from a \$0.5 million increase in marketing expenses (corollary to the \$0.5 million marketing revenues referenced above). The decrease in real estate tax expense was primarily due to a \$0.9 million decrease in Echelon Mall's tax assessment. Real estate taxes increased by \$0.4 million at the remaining properties.

Property operating expenses increased by \$12.2 million, or 10%, in the first nine months of 2006 as compared to the first nine months of 2005, primarily due to an increase of \$8.0 million in expenses from properties acquired in 2005, including operating expenses at Woodland Mall (\$7.0 million), Gadsden Mall (\$0.6 million) and Cumberland Mall (\$0.4 million). Property operating expenses for properties that we owned prior to January 1, 2005 increased by \$4.2 million, or 4%, primarily due to a \$1.6 million increase in common area maintenance expense, a \$0.4 million increase in insurance expense and a \$2.2 million increase in other operating expenses. The increase in other operating expenses resulted primarily from a \$1.5 million increase in marketing expenses (corollary to the \$1.5 million marketing revenues referenced above). Also contributing to the other operating expense increase were higher bad debt expense (\$0.2 million) and an increase in recoverable tenant service expense (\$0.3 million).

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### Other Expenses and Income Taxes

Other expenses increased by \$1.3 million, or 16%, for the three months ended September 30, 2006 as compared to the three months ended September 30, 2005. This increase was due to a \$1.2 million increase in payroll expense related to increased salaries, and incentive compensation and a \$0.1 million increase in professional fees.

Other expenses increased by \$2.2 million, or 8%, in the first nine months of 2006 as compared to same period in 2005. This increase was due to a \$3.1 million increase in payroll expense related to increased salaries and incentive compensation, offset by a \$0.5 million decrease in miscellaneous expenses, a \$0.3 million decrease in legal settlements and a \$0.1 million decrease in income taxes.

### Executive Separation

Executive separation expense in the first nine months of 2006 represents a \$4.0 million expense related to separation costs associated with the retirement of one of the Company's Vice Chairmen.

### Interest Expense

Interest expense increased by \$2.5 million, or 11%, for the three months ended September 30, 2006 as compared to the three months ended September 30, 2005. This increase was due to a \$3.8 million increase primarily related to borrowings in connection with the acquisition of Woodland Mall, along with higher interest rates (a weighted average rate of 7.49% in the third quarter of 2006 versus a weighted average rate of 5.12% in the same period in 2005) under the Credit Facility. These increases in interest expense were partially offset by \$1.1 million of decreased interest expense related to the refinancing of the mortgages on Cherry Hill Mall, Magnolia Mall and Willow Grove Park, (including a \$0.8 million prepayment penalty related to refinancing of the mortgage loan on Magnolia Mall in the third quarter of 2005) and a \$0.2 million decrease in interest paid on mortgage loans that were outstanding during the three months ended September 30, 2006 and 2005 due to principal and debt premium amortization.

Interest expense increased by \$11.3 million, or 18%, in the first nine months of 2006 as compared to the same period in 2005. This increase was due to a \$13.4 million increase primarily related to mortgage, note and Credit Facility interest associated with the financing of the acquisitions of Woodland Mall and Gadsden Mall, along with higher interest rates (a weighted average rate of 6.91% for the nine months ended September 30, 2006 compared to a weighted average rate of 4.83% in the same period in 2005) under the Credit Facility. The increase was also due to an increase of \$0.2 million related to the assumption of mortgage debt in connection with the acquisition of Cumberland Mall in February 2005. These increases in interest expense were partially offset by \$1.4 million of decreased interest expense related to the refinancing of the mortgages on Cherry Hill Mall, Magnolia Mall and Willow Grove Park (including a \$0.8 million prepayment penalty related to refinancing of the mortgage loan on Magnolia Mall in the third quarter of 2005), a \$0.3 million decrease resulting from the reduction in mortgage debt in connection with the sale of, and satisfaction of our mortgage obligations at, the Home Depot parcel at Northeast Tower Center and a \$0.6 million decrease in interest paid on mortgage loans that were outstanding during 2006 and 2005 due to principal and debt premium amortization.

### Depreciation and Amortization

Depreciation and amortization expense increased by \$3.6 million, or 13%, in the three months ended September 30, 2006 as compared to the three months ended September 30, 2005. Depreciation and amortization expense related to properties acquired since July 1, 2005 was \$1.8 million, and expense from properties that we owned prior to July 1, 2005 increased by \$1.8 million, primarily due to a higher asset base resulting from capital improvements to some of those properties, including \$0.3 million of depreciation and amortization expense recorded for Schuylkill Mall, as

described below in further detail.

Depreciation and amortization expense increased by \$14.0 million, or 17%, in the first nine months of 2006 as compared to the first nine months of 2005, primarily due to \$5.9 million of depreciation and amortization expense from properties acquired since January 1, 2005 and \$3.4 million of depreciation and amortization expense recorded for Schuylkill Mall in the first nine months of 2006, including \$2.8 million of depreciation and amortization expense from the date of acquisition (November 2003) through the date that Schuylkill Mall was reclassified into continuing operations (March 2006). This was necessary because depreciation and amortization expense are not recorded when an asset is classified as held for sale and reported as discontinued operations, as Schuylkill Mall was. Depreciation and amortization expense from properties that we owned prior to January 1, 2005, excluding Schuylkill Mall, increased by \$4.7 million, primarily due to a higher asset base resulting from capital improvements to some of those properties.

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### Gains on Sales of Interests in Real Estate

There were no gains from sales of interests in real estate in the three months ended September 30, 2006 compared to \$5.0 million for the three months ended September 30, 2005. There were no gains on sales of interests in real estate in the nine months ended September 30, 2006 compared to \$5.7 million in the nine months ended September 30, 2005. The results of operations for the three and nine months ended September 30, 2005 include a \$5.0 million gain from the sale of our interest in Laurel Mall. The results of operations for the nine months ended September 30, 2005 include the previously mentioned Laurel Mall transaction as well as the sale of the Home Depot parcel.

### Gains on Sales of Non-Operating Real Estate

Gains on sales of non-operating real estate were \$0.2 million and \$3.0 million, respectively, for the three months ended September 30, 2006 and 2005, and \$0.4 million and \$3.1 million, respectively, for the nine months ended September 30, 2006 and 2005. The results of operations for the three and nine months ended September 30, 2005 include a \$3.0 million gain from the sale of an undeveloped land parcel in connection with a litigation settlement related to Christiana Power Center Phase II.

### Discontinued Operations

The Company has presented as discontinued operations the operating results of South Blanding Village, Festival at Exton, the Industrial Properties and the P&S Office Building acquired in connection with the Gadsden Mall transaction.

Property operating results and related minority interest for the properties in discontinued operations for the periods presented were as follows:

(in thousands of dollars)	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2006	2005	2006	2005
Operating results from discontinued operations	\$93	\$272	\$527	\$2,088
Gains on sales of interests in real estate	1,414	3,736	1,414	3,736
Minority interest	(152 )	(447 )	(196 )	(655 )
Income from discontinued operations	\$1,355	\$3,561	\$1,745	\$5,169

### NET OPERATING INCOME

Net operating income (a non-GAAP measure) is derived from real estate revenues (determined in accordance with GAAP) minus property operating expenses (determined in accordance with GAAP). It does not represent cash generated from operating activities in accordance with GAAP and should not be considered to be an alternative to net income (determined in accordance with GAAP) as an indication of the Company's financial performance or to be an alternative to cash flow from operating activities (determined in accordance with GAAP) as a measure of our liquidity; nor is it indicative of funds available for our cash needs, including our ability to make cash distributions. We believe that net income is the most directly comparable GAAP measurement to net operating income. We believe that

net operating income is helpful to management and investors as a measure of operating performance because it is an indicator of the return on property investment, and provides a method of comparing property performance over time. Net operating income excludes management company revenues, interest income, general and administrative expenses, interest expense, depreciation and amortization and gains on sales of real estate and interests in real estate.

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The following tables present net operating income results for the three and nine months ended September 30, 2006 and 2005. The results are presented using the proportionate-consolidation method (a non-GAAP measure), which presents our share of the results of partnerships that we do not consolidate for financial reporting purposes. Under GAAP, we account for our partnership investments under the equity method of accounting. Property operating results for retail properties that we owned for the full periods presented ( Same Store ) includes the results of properties that have undergone or were undergoing redevelopment during the applicable periods, and excludes properties acquired or disposed of during the periods presented:

(in thousands of dollars)	For the Three Months Ended September 30, 2006			For the Three Months Ended September 30, 2005		
	Retail Same Store	Non-Same Store	Total	Retail Same Store	Non-Same Store	Total
Real estate revenues	\$ 112,802	\$ 7,855	\$ 120,657	\$ 111,683	\$ 728	\$ 112,411
Property operating expenses	(44,889 )	(3,263 )	(48,152 )	(43,457 )	(230 )	(43,687 )
Net operating income	\$67,913	\$ 4,592	\$72,505	\$68,226	\$ 498	\$68,724

**Three Months -  
% Change  
2006 vs. 2005**

	Retail Same Store		Total
Real estate revenues	1	% 7	%
Property operating expenses	3	% 10	%
Net operating income	0	% 6	%

(in thousands of dollars)	For the Nine Months Ended September 30, 2006			For the Nine Months Ended September 30, 2005		
	Retail Same Store	Non-Same Store	Total	Retail Same Store	Non-Same Store	Total
Real estate revenues	\$323,640	\$ 36,076	\$359,716	\$320,011	\$ 15,275	\$335,286
Property operating expenses	(124,682 )	(14,324 )	(139,006 )	(120,833 )	(5,618 )	(126,451 )
Net operating income	\$198,958	\$ 21,752	\$220,710	\$199,178	\$ 9,657	\$208,835

**Nine Months  
% Change  
2006 vs. 2005**

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	<b>Retail Same Store</b>	<b>Total</b>	
Real estate revenues	1	% 7	%
Property operating expenses	3	% 10	%
Net operating income	0	% 6	%

Primarily because of the items discussed above under Real Estate Revenues and Property Operating Expenses, total net operating income increased by \$3.8 million in the third quarter of 2006 compared to the third quarter of 2005.

Same Store net operating income decreased by \$0.3 million in the third quarter of 2006 compared to the third quarter of 2005. Non-Same Store net operating income increased by \$4.1 million due to contributions from properties acquired in 2005.

Primarily because of the items discussed above under Real Estate Revenues and Property Operating Expenses, total net operating income increased by \$11.9 million in the first nine months of 2006 compared to the first nine months of 2005. Same Store net operating income decreased by \$0.2 million in the first nine months of 2006 compared to the first nine months of 2005. Non-Same Store net operating income increased by \$12.1 million due to contributions from properties acquired in 2005.

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The following information is provided to reconcile net income to net operating income:

(In thousands of dollars)	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2006	2005	2006	2005
Net income	\$4,544	\$17,895	\$9,048	\$38,190
Adjustments:				
Depreciation and amortization				
Wholly owned and consolidated partnerships	31,118	27,550	94,839	80,801
Unconsolidated partnerships	1,679	1,103	5,255	3,287
Discontinued operations	41	178	144	523
Interest expense				
Wholly owned and consolidated partnerships	24,341	21,859	73,234	61,921
Unconsolidated partnerships	3,248	1,958	8,083	6,036
Minority interest	536	2,265	1,123	4,963
Gains on sales of interests in real estate		(5,024 )		(5,661 )
Gains on sales of non-operating real estate	(166 )	(3,000 )	(381 )	(3,060 )
Gains on sales of discontinued operations	(1,414 )	(3,736 )	(1,414 )	(3,736 )
Other expenses	9,810	8,490	30,570	28,352
Executive separation			3,985	
Management company revenue	(666 )	(521 )	(2,324 )	(2,043 )
Interest and other income	(566 )	(293 )	(1,452 )	(738 )
Net operating income	\$72,505	\$68,724	\$220,710	\$208,835

## FUNDS FROM OPERATIONS

The National Association of Real Estate Investment Trusts ( NAREIT ) defines Funds From Operations, which is a non-GAAP measure, as income before gains and losses on sales of operating properties and extraordinary items (computed in accordance with GAAP); plus real estate depreciation; plus or minus adjustments for unconsolidated partnerships to reflect funds from operations on the same basis. We compute Funds From Operations by taking the amount determined pursuant to the NAREIT definition and subtracting dividends on preferred shares ( FFO ).

Funds From Operations is a commonly used measure of operating performance and profitability in the real estate industry, and we use FFO and FFO per diluted share and OP Unit as supplemental non-GAAP measures to compare our Company's performance for different periods to that of our industry peers. Similarly, FFO on a fully diluted basis is a measure that is useful because it reflects the dilutive impact of outstanding convertible securities. In addition, we use FFO and FFO per diluted share and OP Unit as one of the performance measures for determining bonus amounts earned under certain of our performance-based executive compensation programs. We compute FFO in accordance with standards established by NAREIT, less dividends on preferred shares, which may not be comparable to FFO reported by other REITs that do not define the term in accordance with the current NAREIT definition, or that interpret the current NAREIT definition differently than we do.



FFO does not include gains and losses on sales of operating real estate assets, which are included in the determination of net income in accordance with GAAP. Accordingly, FFO is not a comprehensive measure of our operating cash flows. In addition, since FFO does not include depreciation on real estate assets, FFO may not be a useful performance measure when comparing our operating performance to that of other non-real estate commercial enterprises. We compensate for these limitations by using FFO in conjunction with other GAAP financial performance measures, such as net income and net cash provided by operating activities, and other non-GAAP financial performance measures, such as net operating income. FFO does not represent cash generated from operating activities in accordance with GAAP and should not be considered to be an alternative to net income (determined in accordance with GAAP) as an indication of our financial performance or to be an alternative to cash flow from operating activities (determined in accordance with GAAP) as a measure of our liquidity, nor is it indicative of funds available for our cash needs, including our ability to make cash distributions.

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We believe that net income is the most directly comparable GAAP measurement to FFO. We believe that FFO is helpful to management and investors as a measure of operating performance because it excludes various items included in net income that do not relate to or are not indicative of operating performance, such as various non-recurring events that are considered extraordinary under GAAP, gains on sales of operating real estate and depreciation and amortization of real estate.

FFO was \$32.5 million for the third quarter of 2006, a decrease of \$3.8 million, or 10%, compared to \$36.3 million for the third quarter of 2005. The change in FFO for the third quarter of 2006 compared to the third quarter of 2005 was primarily due to the items discussed in Results of Operations, including a \$3.0 million gain from the sale of non-operating real estate in the third quarter of 2005. FFO per share decreased \$0.08 per diluted share and OP Unit to \$0.80 per diluted share and OP Unit for the third quarter of 2006, compared to \$0.88 per diluted share and OP Unit for the third quarter of 2005.

FFO was \$97.1 million for the first nine months of 2006, a decrease of \$9.7 million, or 9%, compared to \$106.8 million for the first nine months of 2005. The change in FFO for the nine months ended September 30, 2006 compared to the nine months ended September 30, 2005 was primarily due to the items discussed in Results of Operations, including \$4.0 million in executive separation expenses in the first nine months of 2006. Also, FFO for the nine months ended September 30, 2005 included a \$3.0 million gain from the sale of non-operating real estate. FFO per share decreased \$0.21 per diluted share and OP Unit to \$2.37 per diluted share and OP Unit for the first nine months of 2006, compared to \$2.58 per diluted share and OP Unit for the first nine months of 2005.

The shares used to calculate FFO per diluted share include common shares and OP Units not held by us, and exclude preferred shares. FFO per diluted share also includes the effect of preferred share distributions and common share equivalents.

The following information is provided to reconcile net income to FFO, including FFO on a per diluted share and OP Unit basis, and to show the items included in our FFO for the periods indicated:

<b>(in thousands, except per share amounts)</b>	<b>For the Three Months Ended September 30, 2006</b>	<b>Per diluted share and OP Unit</b>	<b>For the Three Months Ended September 30, 2005</b>	<b>Per diluted share and OP Unit</b>
Net income	\$4,544	\$0.11	\$17,895	\$0.43
Minority interest	536	0.01	2,265	0.06
Dividends on preferred shares	(3,403)	(0.08)	(3,403)	(0.08)
Gains on sales of interests in real estate			(5,024)	(0.12)
Gains on sales of discontinued operations	(1,414)	(0.03)	(3,736)	(0.09)
Depreciation and amortization:				
Wholly-owned and consolidated partnerships <sup>(1)</sup>	30,552	0.75	27,062	0.65
Unconsolidated partnerships	1,679	0.04	1,103	0.03
Discontinued operations	41		178	
Funds from operations <sup>(2)</sup>	\$32,535	\$0.80	\$36,340	\$0.88

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