DUKE REALTY CORP
Form 10-Q
May 04, 2012
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q
(Mark One)

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

For the quarterly period ended March 31, 2012
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: 1-9044
DUKE REALTY CORPORATION
(Exact Name of Registrant as Specified in Its Charter)

Indiana (State or Other Jurisdiction of Incorporation or Organization)	35-1740409 (I.R.S. Employer Identification Number)
600 East 96th Street, Suite 100 Indianapolis, Indiana (Address of Principal Executive Offices)	46240 (Zip Code)

Registrant's Telephone Number, Including Area Code: (317) 808-6000

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

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

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act): YES ¨ NO x

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

Class	Outstanding at May 4, 2012
Common Stock, $.01 par value per share	266,446,952

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PART I - FINANCIAL INFORMATION
Item 1. Financial Statements
DUKE REALTY CORPORATION AND SUBSIDIARIES
Consolidated Balance Sheets
(in thousands, except per share amounts)

	March 31, 2012 (Unaudited)	December 31, 2011
ASSETS		
Real estate investments:		
Land and improvements	$1,209,840	$1,202,872
Buildings and tenant improvements	4,868,066	4,766,793
Construction in progress	80,306	44,259
Investments in and advances to unconsolidated companies	361,818	364,859
Undeveloped land	622,642	622,635
	7,142,672	7,001,418
Accumulated depreciation	(1,151,322)	(1,108,650)
Net real estate investments	5,991,350	5,892,768
Real estate investments and other assets held-for-sale	19,395	55,580
Cash and cash equivalents	14,740	213,809
Accounts receivable, net of allowance of $2,693 and $3,597	24,045	22,255
Straight-line rent receivable, net of allowance of $6,997 and $7,447	111,115	105,900
Receivables on construction contracts, including retentions	33,257	40,247
Deferred financing costs, net of accumulated amortization of $42,720 and $59,109	39,685	42,268
Deferred leasing and other costs, net of accumulated amortization of $311,525 and $292,334	469,936	460,881
Escrow deposits and other assets	168,882	170,729
	$6,872,405	$7,004,437
LIABILITIES AND EQUITY		
Indebtedness:		
Secured debt	$1,180,965	$1,173,233
Unsecured notes	2,615,612	2,616,063
Unsecured lines of credit	20,293	20,293
	3,816,870	3,809,589
Liabilities related to real estate investments held-for-sale	643	975
Construction payables and amounts due subcontractors, including retentions	51,309	55,775
Accrued real estate taxes	76,263	69,272
Accrued interest	33,675	58,904
Other accrued expenses	29,058	60,174
Other liabilities	132,734	131,735
Tenant security deposits and prepaid rents	46,383	38,355
Total liabilities	4,186,935	4,224,779
Shareholders' equity:		
Preferred shares ($.01 par value); 5,000 shares authorized; 2,503 and 3,176 shares issued and outstanding	625,638	793,910

Common shares ($.01 par value); 400,000 shares authorized; 266,405 and 252,927 shares issued and outstanding	2,664	2,529
Additional paid-in capital	3,780,293	3,594,588
Accumulated other comprehensive income	1,506	987
Distributions in excess of net income	(1,758,467)	(1,677,328)
Total shareholders’ equity	2,651,634	2,714,686
Noncontrolling interests	33,836	64,972
Total equity	2,685,470	2,779,658
	$6,872,405	$7,004,437

See accompanying Notes to Consolidated Financial Statements

DUKE REALTY CORPORATION AND SUBSIDIARIES
Consolidated Statements of Operations and Comprehensive Income
For the three months ended March 31,
(in thousands, except per share amounts)
(Unaudited)

	Three Months Ended	
	2012	2011
Revenues:		
Rental and related revenue	$203,432	$190,986
General contractor and service fee revenue	68,968	146,547
	272,400	337,533
Expenses:		
Rental expenses	37,342	40,699
Real estate taxes	28,671	27,471
General contractor and other services expenses	63,921	135,664
Depreciation and amortization	91,613	77,822
	221,547	281,656
Other operating activities:		
Equity in earnings of unconsolidated companies	1,509	1,073
Gain on sale of properties	(277)	67,856
Undeveloped land carrying costs	(2,298)	(2,309)
Other operating expenses	(265)	(85)
General and administrative expenses	(11,839)	(11,197)
	(13,170)	55,338
Operating income	37,683	111,215
Other income (expenses):		
Interest and other income, net	146	87
Interest expense	(61,086)	(52,124)
Acquisition-related activity	(580)	(589)
Income (loss) from continuing operations	(23,837)	58,589
Discontinued operations:		
Loss before gain on sales	(749)	(5,403)
Gain on sale of depreciable properties	6,476	11,603
Income from discontinued operations	5,727	6,200
Net income (loss)	(18,110)	64,789
Dividends on preferred shares	(13,193)	(15,974)
Adjustments for redemption/repurchase of preferred shares	(5,730)	(163)
Net (income) loss attributable to noncontrolling interests	643	(1,083)
Net income (loss) attributable to common shareholders	$(36,390)	$47,569
Basic net income (loss) per common share:		
Continuing operations attributable to common shareholders	$(0.16)	$0.16
Discontinued operations attributable to common shareholders	0.02	0.03
Total	$(0.14)	$0.19
Diluted net income (loss) per common share:		
Continuing operations attributable to common shareholders	$(0.16)	$0.16
Discontinued operations attributable to common shareholders	0.02	0.03
Total	$(0.14)	$0.19
Weighted average number of common shares outstanding	258,365	252,406
Weighted average number of common shares and potential dilutive securities	258,365	258,837

Comprehensive income (loss):		
Net income (loss)	$(18,110)	$64,789
Other comprehensive income:		
Derivative instrument activity	519	771
Other comprehensive income	519	771
Comprehensive income (loss)	$(17,591)	$65,560

See accompanying Notes to Consolidated Financial Statements

DUKE REALTY CORPORATION AND SUBSIDIARIES
Consolidated Statements of Cash Flows
For the three months ended March 31,
(in thousands)
(Unaudited)

	2012	2011
Cash flows from operating activities:		
Net income (loss)	$(18,110)	$64,789
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation of buildings and tenant improvements	63,860	67,063
Amortization of deferred leasing and other costs	28,396	27,918
Amortization of deferred financing costs	3,246	3,644
Straight-line rent adjustment	(5,852)	(6,966)
Earnings from land and depreciated property sales	(6,199)	(79,459)
Third-party construction contracts, net	(1,877)	(13,974)
Other accrued revenues and expenses, net	(43,116)	(42,945)
Operating distributions received in excess of equity in earnings from unconsolidated companies	4,995	7,955
Net cash provided by operating activities	25,343	28,025
Cash flows from investing activities:		
Development of real estate investments	(29,639)	(37,318)
Acquisition of real estate investments and related intangible assets	(131,515)	(22,261)
Acquisition of undeveloped land	(12,180)	—
Second generation tenant improvements, leasing costs and building improvements	(15,361)	(17,476)
Other deferred leasing costs	(9,142)	(6,272)
Other assets	502	2,816
Proceeds from land and depreciated property sales, net	63,281	437,494
Capital distributions from unconsolidated companies	—	54,730
Capital contributions and advances to unconsolidated companies, net	(3,521)	(6,068)
Net cash provided by (used for) investing activities	(137,575)	405,645
Cash flows from financing activities:		
Proceeds from issuance of common shares, net	146,969	—
Payments for redemption/repurchase of preferred shares	(168,272)	(2,096)
Payments on unsecured debt	(451)	(42,948)
Payments on secured indebtedness including principal amortization	(10,455)	(3,897)
Payments on lines of credit, net	—	(174,717)
Distributions to common shareholders	(43,922)	(42,892)
Distributions to preferred shareholders	(9,467)	(15,974)
Distributions to noncontrolling interests	(1,033)	(1,145)
Deferred financing costs	(206)	(1,270)
Net cash used for financing activities	(86,837)	(284,939)
Net increase (decrease) in cash and cash equivalents	(199,069)	148,731
Cash and cash equivalents at beginning of period	213,809	18,384
Cash and cash equivalents at end of period	$14,740	$167,115
Non-cash investing and financing activities:		
Assumption of indebtedness and other liabilities in real estate acquisitions	$19,626	$85,955
Contribution of properties to unconsolidated companies	$—	$52,110
Conversion of Limited Partner Units to common shares	$29,460	$933
Issuance of Limited Partner Units for acquisition	$—	$28,357
Preferred distributions declared but not paid	$3,726	$—

See accompanying Notes to Consolidated Financial Statements

DUKE REALTY CORPORATION AND SUBSIDIARIES
Consolidated Statement of Changes in Equity
For the three months ended March 31, 2012
(in thousands, except per share data)
(Unaudited)

	Common Shareholders						
	Preferred Stock	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income	Distributions in Excess of Net Income	Non-Controlling Interests	Total
Balance at December 31, 2011	$793,910	$2,529	$3,594,588	$987	$(1,677,328)	$64,972	$2,779,658
Net loss	—	—	—	—	(17,467)	(643)	(18,110)
Other comprehensive income	—	—	—	519	—	—	519
Issuance of common shares		108	146,329		—		146,437
Stock based compensation plan activity	—	4	4,209	—	(827)	—	3,386
Conversion of Limited Partner Units	—	23	29,437	—	—	(29,460)	—
Distributions to preferred shareholders	—	—	—	—	(13,193)	—	(13,193)
Redemption of preferred shares	(168,272)	—	5,730	—	(5,730)	—	(168,272)
Distributions to common shareholders ($0.17 per share)	—	—	—	—	(43,922)	—	(43,922)
Distributions to noncontrolling interests	—	—	—	—	—	(1,033)	(1,033)
Balance at March 31, 2012	$625,638	$2,664	$3,780,293	$1,506	$(1,758,467)	$33,836	$2,685,470

See accompanying Notes to Consolidated Financial Statements

DUKE REALTY CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. General Basis of Presentation

The interim consolidated financial statements included herein have been prepared by Duke Realty Corporation (the "Company"). The 2011 year-end consolidated balance sheet data included in this Quarterly Report on Form 10-Q (this "Report") was derived from the audited financial statements in our Annual Report on Form 10-K for the year ended December 31, 2011, but does not include all disclosures required by accounting principles generally accepted in the United States of America ("GAAP"). The financial statements have been prepared in accordance with GAAP for interim financial information and in accordance with Rule 10-01 of Regulation S-X of the Securities Exchange Act of 1934, as amended. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and revenue and expenses during the reporting period. Our actual results could differ from those estimates and assumptions. These financial statements should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations included herein and the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2011.

We believe that we qualify as a real estate investment trust ("REIT") under the provisions of the Internal Revenue Code of 1986, as amended (the "Code"). Substantially all of our Rental Operations (see Note 9) are conducted through Duke Realty Limited Partnership ("DRLP"). We owned approximately 98.3% of the common partnership interests of DRLP ("Units") at March 31, 2012. At the option of the holders, and subject to certain restrictions, the remaining Units are redeemable for shares of our common stock on a one-to-one basis and earn dividends at the same rate as shares of our common stock. If it is determined to be necessary in order to continue to qualify as a REIT, we may elect to purchase the Units for an equivalent amount of cash rather than issuing shares of common stock upon redemption. We conduct our Service Operations (see Note 9) through Duke Realty Services, LLC, Duke Realty Services Limited Partnership and Duke Construction Limited Partnership ("DCLP"), which are consolidated entities that are 100% owned by a combination of us and DRLP. DCLP is owned through a taxable REIT subsidiary. The consolidated financial statements include our accounts and the accounts of our majority-owned or controlled subsidiaries. In this Report, unless the context indicates otherwise, the terms "we," "us" and "our" refer to the Company and those entities owned or controlled by the Company.

2. Reclassifications

Certain amounts in the accompanying consolidated financial statements for 2011 have been reclassified to conform to the 2012 consolidated financial statement presentation.

3. Variable Interest Entities

At March 31, 2012, there are three unconsolidated joint ventures that we have determined meet the criteria to be considered variable interest entities ("VIEs"). These three unconsolidated joint ventures were formed with the sole purpose of developing, constructing, leasing, marketing and selling or operating properties. The business activities of these unconsolidated joint ventures have been financed through a combination of equity contributions, partner/member loans, and third-party debt that is guaranteed by both us and the other partner/member of each entity. All significant decisions for these unconsolidated joint ventures, including those decisions that most significantly impact each venture's economic performance, require unanimous approval of each joint venture's partners or members. In certain cases, these decisions also require lender approval. Unanimous approval requirements for these unconsolidated joint ventures include entering into new leases, setting annual operating budgets, selling underlying properties, and incurring additional indebtedness. Because no single entity exercises control over the decisions that most significantly affect each joint venture's economic performance, we determined that the equity method of accounting is appropriate.

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The following is a summary of the carrying value in our consolidated balance sheet, as well as our maximum loss exposure under guarantees for the three unconsolidated subsidiaries that we have determined to be VIEs as of March 31, 2012 (in millions):

	Carrying Value	Maximum Loss Exposure
Investment in Unconsolidated Companies	$33.5	$33.5
Guarantee Obligations (1)	$(16.6)	$(55.9)

(1) We are party to guarantees of the third-party debt of these joint ventures and our maximum loss exposure is equal to the maximum monetary obligation pursuant to the guarantee agreements. We have recorded a liability for our probable future obligation under a guarantee to the lender of one of these ventures. Pursuant to an agreement with the lender, we may make partner loans to this joint venture that will reduce our maximum guarantee obligation on a dollar-for-dollar basis. The carrying value of our recorded guarantee obligations is included in other liabilities in our Consolidated Balance Sheets.

4. Acquisitions and Dispositions

2012 Acquisitions

We acquired seven operating properties during the three months ended March 31, 2012. These acquisitions consisted of one industrial property near Chicago, Illinois, two industrial properties in Columbus, Ohio and four medical office properties in various markets. The following table summarizes our allocation of the fair value of amounts recognized for each major class of assets and liabilities (in thousands) for these acquisitions:

Real estate assets	$130,615
Lease related intangible assets	22,451
Other assets	2,829
Total acquired assets	155,895
Secured debt	18,741
Other liabilities	885
Total assumed liabilities	19,626
Fair value of acquired net assets	$136,269

The leases in the acquired properties had a weighted average remaining life at acquisition of approximately 8.7 years.

Fair Value Measurements

The fair value estimates used in allocating the aggregate purchase price of each acquisition among the individual components of real estate assets and liabilities were determined primarily through calculating the “as-if vacant” value of each building, using the income approach, and relied significantly upon internally determined assumptions. As a result, we have, thus, determined these estimates to have been primarily based upon Level 3 inputs, which are unobservable inputs based on our own assumptions. The range of most significant assumptions utilized in making the lease-up and future disposition estimates used in calculating the “as-if vacant” value of each building acquired during the three months ended March 31, 2012 were as follows:

	Low	High
Discount rate	7.19%	8.78%
Exit capitalization rate	6.09%	7.40%
Lease-up period (months)	9	19
Net rental rate per square foot – Industrial	$2.75	$3.59
Net rental rate per square foot – Medical Office	$16.10	$26.14

Dispositions

We disposed of income-producing real estate assets and undeveloped land and received net proceeds of $63.3 million and $437.5 million, respectively, during the three months ended March 31, 2012 and 2011.

5. Indebtedness

The following table summarizes the book value and changes in the fair value of our debt for the three months ended March 31, 2012 (in thousands):

	Book Value at 12/31/11	Book Value at 3/31/12	Fair Value at 12/31/11	Issuances and Assumptions	Payoffs	Adjustments to Fair Value	Fair Value at 3/31/12
Fixed rate secured debt	$1,167,188	$1,174,920	$1,256,331	$18,741	$(11,009)	$(840)	$1,263,223
Variable rate secured debt	6,045	6,045	6,045	—	—	—	6,045
Unsecured notes	2,616,063	2,615,612	2,834,610	—	(451)	59,227	2,893,386
Unsecured lines of credit	20,293	20,293	20,244	—	—	4	20,248
Total	$3,809,589	$3,816,870	$4,117,230	$18,741	$(11,460)	$58,391	$4,182,902

Fixed Rate Secured Debt

Because our fixed rate secured debt is not actively traded in any marketplace, we utilized a discounted cash flow methodology to determine its fair value. Accordingly, we calculated fair value by applying an estimate of the current market rate to discount the debt's remaining contractual cash flows. Our estimate of a current market rate, which is the most significant input in the discounted cash flow calculation, is intended to replicate debt of similar maturity and loan-to-value relationship. The estimated rates ranged from 3.50% to 5.40%, depending on the attributes of the specific loans. The current market rates we utilized were internally estimated; therefore, we have concluded that our determination of fair value for our fixed rate secured debt was primarily based upon Level 3 inputs.

We assumed one secured loan in conjunction with our acquisition activity in 2012. This assumed loan had a total face value of $18.1 million and fair value of $18.7 million. This assumed loan carries a stated interest rate of 5.14% and a remaining term upon acquisition of 2.2 years. We used an estimated market rate of 3.50% in determining the fair value of this loan.

Unsecured Notes

All but $21.0 million of our unsecured notes bear interest at fixed rates. We utilized broker estimates in estimating the fair value of our fixed rate unsecured debt. Our unsecured notes are thinly traded and, in certain cases, the broker estimates were not based upon comparable transactions. The broker estimates took into account any recent trades within the same series of our fixed rate unsecured debt, comparisons to recent trades of other series of our fixed rate unsecured debt, trades of fixed rate unsecured debt from companies with profiles similar to ours, as well as overall economic conditions. We reviewed these broker estimates for reasonableness and accuracy, considering whether the estimates were based upon market participant assumptions within the principal and most advantageous market and whether any other observable inputs would be more accurate indicators of fair value than the broker estimates. We concluded that the broker estimates were representative of fair value. We have determined that our estimation of the fair value of our fixed rate unsecured debt was primarily based upon Level 3 inputs, as defined. The estimated trading values of our fixed rate unsecured debt, depending on the maturity and coupon rates, ranged from 102.00% to 124.00% of face value.

The indentures (and related supplemental indentures) governing our outstanding series of notes also require us to comply with financial ratios and other covenants regarding our operations. We were in compliance with all such covenants as of March 31, 2012.

Unsecured Lines of Credit

Our unsecured lines of credit as of March 31, 2012 are described as follows (in thousands):

Description	Maximum Capacity	Maturity Date	Outstanding Balance at March 31, 2012
Unsecured Line of Credit - DRLP	$850,000	December 2015	$—
Unsecured Line of Credit - Consolidated Subsidiary	$30,000	July 2012	$20,293

The DRLP unsecured line of credit has an interest rate on borrowings of LIBOR plus 1.25%, and a maturity date of December 2015. Subject to certain conditions, the terms also include an option to increase the facility by up to an additional $400.0 million, for a total of up to $1.25 billion.

This line of credit provides us with an option to obtain borrowings from financial institutions that participate in the line at rates that may be lower than the stated interest rate, subject to certain restrictions.

This line of credit contains financial covenants that require us to meet certain financial ratios and defined levels of performance, including those related to fixed charge coverage, unsecured interest expense coverage and debt-to-asset value (with asset value being defined in the DRLP unsecured line of credit agreement). As of March 31, 2012, we were in compliance with all covenants under this line of credit.

The consolidated subsidiary’s unsecured line of credit allows for borrowings up to $30.0 million at a rate of LIBOR plus 0.85% (equal to 1.09% for outstanding borrowings as of March 31, 2012). This unsecured line of credit is used to fund development activities within the consolidated subsidiary and matures in July 2012.

To the extent that there are outstanding borrowings, we utilize a discounted cash flow methodology in order to estimate the fair value of our unsecured lines of credit. The net present value of the difference between future contractual interest payments and future interest payments based on our estimate of a current market rate represents the difference between the book value and the fair value. Our estimate of a current market rate is based upon the rate, considering current market conditions and our specific credit profile, at which we estimate we could obtain similar borrowings. The current market rate of 1.74% that we utilized was internally estimated; therefore, we have concluded that our determination of fair value for our consolidated subsidiary's unsecured line of credit was primarily based upon a Level 3 input.

6. Shareholders' Equity

In March 2012, we redeemed all of the outstanding shares of our 6.95% Series M Cumulative Redeemable Preferred Shares at a liquidation amount of $168.3 million. Original offering costs of $5.7 million were included as a reduction to net loss attributable to common shareholders in conjunction with the redemption of these shares.

In the first three months of 2012, we issued 10.8 million shares of common stock pursuant to our at the market offering, generating net proceeds of approximately $147.0 million. We paid $3.0 million in commissions related to the sale of these common shares. The proceeds from this offering were contributed to DRLP in exchange for additional Units in DRLP and were used for acquisitions, general corporate purposes and redemption of preferred shares and fixed rate secured debt.

7. Related Party Transactions

We provide property management, asset management, leasing, construction and other tenant related services to unconsolidated companies in which we have equity interests. We recorded the corresponding fees based on contractual terms that approximate market rates for these types of services and we have eliminated our ownership percentage of these fees in the consolidated financial statements. The following table summarizes the fees earned from these companies for the three months ended March 31, 2012 and 2011, respectively (in thousands):

	Three Months Ended March 31,	
	2012	2011
Management fees	$2,731	$1,977
Leasing fees	1,294	1,804
Construction and development fees	843	1,581

8. Net Income (Loss) Per Common Share

Basic net income (loss) per common share is computed by dividing net income (loss) attributable to common shareholders, less dividends on share-based awards expected to vest (referred to as “participating securities” and primarily composed of unvested restricted stock units), by the weighted average number of common shares outstanding for the period. Diluted net income (loss) per common share is computed by dividing the sum of basic net income (loss) attributable to common shareholders and the noncontrolling interest in earnings allocable to Units not owned by us (to the extent the Units are dilutive) by the sum of the weighted average number of common shares outstanding and, to the extent they are dilutive, Units outstanding, as well as any potential dilutive securities for the period.

The following table reconciles the components of basic and diluted net income (loss) per common share for the three months ended March 31, 2012 and 2011, respectively (in thousands):

	Three Months Ended March 31,	
	2012	2011
Net income (loss) attributable to common shareholders	$(36,390)	$47,569
Less: Dividends on participating securities	(852)	(799)
Basic net income (loss) attributable to common shareholders	(37,242)	46,770
Noncontrolling interest in earnings of common unitholders	—	1,205
Diluted net income (loss) attributable to common shareholders	$(37,242)	$47,975
Weighted average number of common shares outstanding	258,365	252,406
Weighted average partnership Units outstanding	—	6,384
Other potential dilutive shares	—	47
Weighted average number of common shares and potential dilutive securities	258,365	258,837

The partnership Units are anti-dilutive for the three months ended March 31, 2012 as a result of the net loss for this period. In addition, substantially all potential shares related to our stock-based compensation plans were anti-dilutive for both periods presented and potential shares related to our 3.75% Exchangeable Senior Notes (“Exchangeable Notes”), which were repaid in December 2011, were anti-dilutive for the three months ended March 31, 2011. The following table summarizes the data that is excluded from the computation of net income (loss) per common share as a result of being anti-dilutive (in thousands):

	Three Months Ended March 31,	
	2012	2011
Noncontrolling interest in earnings of common unitholders	$(811)	$—
Weighted average partnership Units outstanding	5,749	—
Other potential dilutive shares:		
Anti-dilutive outstanding potential shares under fixed stock option and other stock-based compensation plans	1,733	1,711
Anti-dilutive potential shares under the Exchangeable Notes	—	3,432
Outstanding participating securities	5,051	4,752

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9. Segment Reporting

We have four reportable operating segments at March 31, 2012, the first three of which consist of the ownership and rental of (i) industrial, (ii) office and (iii) medical office real estate investments. The operations of our industrial, office and medical office properties, along with our retail properties, are collectively referred to as “Rental Operations.” Our retail properties, as well as any other properties not included in our reportable segments, do not by themselves meet the quantitative thresholds for separate presentation as a reportable segment. The fourth reportable segment consists of various real estate services such as property management, asset management, maintenance, leasing, development and construction management to third-party property owners and joint ventures, and is collectively referred to as “Service Operations.” Our reportable segments offer different products or services and are managed separately because each segment requires different operating strategies and management expertise.

As of March 31, 2012, one of the quantitative thresholds was triggered, which required our medical office property operating segment to be presented as a separate reportable segment. As such, our medical office properties are presented as a separate reportable segment for the three-month period ended March 31, 2012 as well as for the comparative prior period.

Other revenue consists of other operating revenues not identified with one of our operating segments. Interest expense and other non-property specific revenues and expenses are not allocated to individual segments in determining our performance measure.

We assess and measure our overall operating results based upon an industry performance measure referred to as Funds From Operations (“FFO”), which management believes is a useful indicator of our consolidated operating performance. FFO is used by industry analysts and investors as a supplemental operating performance measure of a REIT. The National Association of Real Estate Investment Trusts (“NAREIT”) created FFO as a supplemental measure of REIT operating performance that excludes historical cost depreciation, among other items, from net income determined in accordance with GAAP. FFO is a non-GAAP financial measure. The most comparable GAAP measure is net income (loss) attributable to common shareholders. FFO attributable to common shareholders should not be considered as a substitute for net income (loss) attributable to common shareholders or any other measures derived in accordance with GAAP and may not be comparable to other similarly titled measures of other companies. FFO is calculated in accordance with the definition that was adopted by the Board of Governors of NAREIT. We do not allocate certain income and expenses (“Non-Segment Items”, as shown in the table below) to our operating segments. Thus, the operational performance measure presented here on a segment-level basis represents net earnings, excluding depreciation expense and the Non-Segment Items not allocated, and is not meant to present FFO as defined by NAREIT.

Historical cost accounting for real estate assets in accordance with GAAP implicitly assumes that the value of real estate assets diminishes predictably over time. Since real estate values instead have historically risen or fallen with market conditions, many industry analysts and investors have considered presentation of operating results for real estate companies that use historical cost accounting to be insufficient by themselves. FFO, as defined by NAREIT, represents GAAP net income (loss), excluding extraordinary items as defined under GAAP and gains or losses from sales of previously depreciated real estate assets, impairment charges related to depreciable real estate assets, plus certain non-cash items such as real estate asset depreciation and amortization, and after similar adjustments for unconsolidated partnerships and joint ventures.

Management believes that the use of FFO attributable to common shareholders, combined with net income (which remains the primary measure of performance), improves the understanding of operating results of REITs among the investing public and makes comparisons of REIT operating results more meaningful. Management believes that excluding gains or losses related to sales of previously depreciated real estate assets, impairment charges related to depreciable real estate assets and real estate asset depreciation and amortization enables investors and analysts to readily identify the operating results of the long-term assets that form the core of a REIT’s activity and assist them in comparing these operating results between periods or between different companies.

The following table shows (i) the revenues for each of the reportable segments and (ii) a reconciliation of FFO attributable to common shareholders to net income (loss) attributable to common shareholders for the three months ended March 31, 2012 and 2011, respectively (in thousands):

	Three Months Ended March 31, 2012	2011
Revenues		
Rental Operations:		
Industrial	$108,487	$94,262
Office	67,417	75,602
Medical Office	20,741	13,484
Non-reportable Rental Operations	5,658	5,655
General contractor and service fee revenue (“Service Operations”)	68,968	146,547
Total Segment Revenues	271,271	335,550
Other Revenue	1,129	1,983
Consolidated Revenue from continuing operations	272,400	337,533
Discontinued Operations	1,234	52,170
Consolidated Revenue	$273,634	$389,703
Reconciliation of Funds From Operations		
Net earnings excluding depreciation and Non-Segment Items		
Industrial	$79,902	$66,726
Office	39,490	43,100
Medical Office	13,667	7,802
Non-reportable Rental Operations	4,008	4,207
Service Operations	5,047	10,883
	142,114	132,718
Non-Segment Items:		
Interest expense	(61,086)	(52,124)
Interest and other income	146	87
Other operating expenses	(265)	(85)
General and administrative expenses	(11,839)	(11,197)
Undeveloped land carrying costs	(2,298)	(2,309)
Acquisition-related activity	(580)	(589)
Other non-segment income	352	981
Net (income) loss attributable to noncontrolling interests	643	(1,083)
Noncontrolling interest share of FFO adjustments	(2,060)	(569)
Joint venture items	10,095	8,610
Dividends on preferred shares	(13,193)	(15,974)
Adjustments for redemption/repurchase of preferred shares	(5,730)	(163)
Discontinued operations	(106)	11,756
FFO attributable to common shareholders	56,193	70,059
Depreciation and amortization on continuing operations	(91,613)	(77,822)
Depreciation and amortization on discontinued operations	(643)	(17,159)
Company’s share of joint venture adjustments	(8,586)	(7,628)
Earnings from depreciated property sales on continuing operations	(277)	67,856
Earnings from depreciated property sales on discontinued operations	6,476	11,603
Earnings from depreciated property sales—share of joint venture	—	91
Noncontrolling interest share of FFO adjustments	2,060	569
Net income (loss) attributable to common shareholders	$(36,390)	$47,569

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The assets for each of the reportable segments as of March 31, 2012 and December 31, 2011 are as follows (in thousands):

	March 31, 2012	December 31, 2011
Assets		
Rental Operations:		
Industrial	$3,634,930	$3,586,250
Office	1,683,691	1,742,196
Medical Office	674,298	580,177
Non-reportable Rental Operations	202,139	209,056
Service Operations	162,468	167,382
Total Segment Assets	6,357,526	6,285,061
Non-Segment Assets	514,879	719,376
Consolidated Assets	$6,872,405	$7,004,437

10. Discontinued Operations and Assets Held for Sale

The following table illustrates the number of properties in discontinued operations:

	Held for Sale at March 31, 2012	Sold in 2012	Sold in 2011	Total
Office	0	7	93	100
Industrial	2	6	7	15
Retail	1	0	1	2
	3	13	101	117

We allocate interest expense to discontinued operations and have included such interest expense in computing income from discontinued operations. Interest expense allocable to discontinued operations includes interest on any secured debt for properties included in discontinued operations and an allocable share of our consolidated unsecured interest expense for unencumbered properties. The allocation of unsecured interest expense to discontinued operations was based upon the gross book value of the unencumbered real estate assets included in discontinued operations as it related to the total gross book value of our unencumbered real estate assets.

The following table illustrates the operations of the buildings reflected in discontinued operations for the three months ended March 31, 2012 and 2011, respectively (in thousands):

	Three Months Ended March 31,	
	2012	2011
Revenues	$1,234	$52,170
Operating expenses	(815)	(25,273)
Depreciation and amortization	(643)	(17,159)
Operating income (loss)	(224)	9,738
Interest expense	(525)	(15,141)
Loss before gain on sales	(749)	(5,403)
Gain on sale of depreciable properties	6,476	11,603
Income from discontinued operations	$5,727	$6,200

Dividends on preferred shares and adjustments for the redemption or repurchase of preferred shares are allocated entirely to continuing operations. The following table illustrates the allocation of the income (loss) attributable to common shareholders between continuing operations and discontinued operations, reflecting an allocation of income or loss attributable to noncontrolling interests between continuing and discontinued operations, for the three months ended March 31, 2012 and 2011, respectively (in thousands):

	Three Months Ended March 31,	
	2012	2011
Income (loss) from continuing operations attributable to common shareholders	$(41,992)	$41,522
Income from discontinued operations attributable to common shareholders	5,602	6,047
Net income (loss) attributable to common shareholders	$(36,390)	$47,569

At March 31, 2012, we classified three in-service properties as held-for-sale, which were included in discontinued operations, due to our present intention to sell the properties in the second quarter. The following table illustrates aggregate balance sheet information of the aforementioned three properties included in discontinued operations at March 31, 2012 (in thousands):

Real estate investment, net	$18,159
Other assets	1,236
Total assets held-for-sale	$19,395
Accrued expenses	$434
Other liabilities	209
Total liabilities held-for-sale	$643

11. Subsequent Events

Declaration of Dividends

Our board of directors declared the following dividends at its regularly scheduled board meeting held on April 25, 2012:

Class	Quarterly Amount/Share	Record Date	Payment Date
Common	$0.17	May 16, 2012	May 31, 2012
Preferred (per depositary share):			
Series J	$0.414063	May 16, 2012	May 31, 2012
Series K	$0.406250	May 16, 2012	May 31, 2012
Series L	$0.412500	May 16, 2012	May 31, 2012
Series O	$0.523437	June 15, 2012	July 2, 2012

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

The following Management's Discussion and Analysis of Financial Condition and Results of Operations is intended to help the reader understand our operations and our present business environment. Management's Discussion and Analysis is provided as a supplement to and should be read in conjunction with our consolidated financial statements and the notes thereto, contained in Part I, Item I of this Quarterly Report on Form 10-Q (this "Report") and the consolidated financial statements and notes thereto, contained in Part IV, Item 15 of our Annual Report on Form 10-K for the year ended December 31, 2011, as filed with the Securities and Exchange Commission (the "SEC") on February 24, 2012. As used herein, the terms "we", "us" and "our" refer to Duke Realty Corporation (the "Company") and those entities owned or controlled by the Company.

Cautionary Notice Regarding Forward-Looking Statements

Certain statements contained in or incorporated by reference into this Report including, without limitation, those related to our future operations, constitute "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. The words "believe," "estimate," "expect," "anticipate," "intend," "plan," "seek," "may," and similar expressions or statements regarding periods are intended to identify forward-looking statements.

These forward-looking statements involve known and unknown risks, uncertainties and other important factors that could cause our actual results, performance or achievements, or industry results, to differ materially from any predictions of future results, performance or achievements that we express or imply in this Report. Some of the risks, uncertainties and other important factors that may affect future results include, among others:

- Changes in general economic and business conditions, including the financial condition of our tenants and the value of our real estate assets;
- Our continued qualification as a real estate investment trust ("REIT") for U.S. federal income tax purposes;
- Heightened competition for tenants and potential decreases in property occupancy;
- Potential changes in the financial markets and interest rates;
- Volatility in our stock price and trading volume;
- Our continuing ability to raise funds on favorable terms;
- Our ability to successfully identify, acquire, develop and/or manage properties on terms that are favorable to us;
- Potential increases in real estate construction costs;
- Our ability to successfully dispose of properties on terms that are favorable to us, including, without limitation, through one or more transactions that are consistent with our previously disclosed strategic plans;
- Our ability to retain our current credit ratings;
- Inherent risks in the real estate business, including, but not limited to, tenant defaults, potential liability relating to environmental matters, climate change and liquidity of real estate investments; and
- Other risks and uncertainties described herein, as well as those risks and uncertainties discussed from time to time in our other reports and other public filings with the SEC.

Although we presently believe that the plans, expectations and results expressed in or suggested by the forward-looking statements are reasonable, all forward-looking statements are inherently subjective, uncertain and subject to change, as they involve substantial risks and uncertainties beyond our control. New factors emerge from time to time, and it is not possible for us to predict the nature, or assess the potential impact, of each new factor on our business. Given these uncertainties, we caution you not to place undue reliance on these forward-looking statements. We undertake no obligation to update or revise any of our forward-looking statements for events or circumstances that arise after the statement is made, except as otherwise may be required by law.

This list of risks and uncertainties, however, is only a summary of some of the most important factors and is not intended to be exhaustive. Additional information regarding risk factors that may affect us is included under the caption "Risk Factors" in Part II, Item 1A of this Report, and in our Annual Report on Form 10-K for the fiscal year ended December 31, 2011, which we filed with the SEC on February 24, 2012. The risk factors contained in our Annual Report are updated by us from time to time in Quarterly Reports on Form 10-Q and other public filings.

Business Overview

We are a self-administered and self-managed REIT that began operations through a related entity in 1972. A more complete description of our business, and of management's philosophy and priorities, is included in our 2011 Annual Report on Form 10-K.

As of March 31, 2012, we:

- Owned or jointly controlled 747 industrial, office, medical office and other properties, of which 738 properties with more than 136.5 million square feet are in service and nine properties with more than 2.4 million square feet are under development. The 738 in-service properties are comprised of 612 consolidated properties with more than 111.2 million square feet and 126 jointly controlled unconsolidated properties with approximately 25.3 million square feet. The nine properties under development consist of seven consolidated properties with approximately 1.8 million square feet and two jointly controlled unconsolidated properties with approximately 650,000 square feet.
- Owned, including through ownership interests in unconsolidated joint ventures, more than 4,800 acres of land and controlled more than 1,600 acres through purchase options.

A key component of our overall strategy is to increase our investment in quality industrial properties in both existing and select new markets, expand our medical office portfolio nationally to take advantage of demographic trends and to reduce our investment in suburban office properties and other non-strategic assets.

We have four reportable operating segments at March 31, 2012, the first three of which consist of the ownership and rental of (i) industrial, (ii) office and (iii) medical office real estate investments. The operations of our industrial, office and medical office properties, along with our retail properties, are collectively referred to as "Rental Operations." Our retail properties, as well as any other properties not included in our reportable segments, do not by themselves meet the quantitative thresholds for separate presentation as a reportable segment. The fourth reportable segment consists of various real estate services such as property management, asset management, maintenance, leasing, development and construction management to third-party property owners and joint ventures, and is collectively referred to as "Service Operations." Our reportable segments offer different products or services and are managed separately because each segment requires different operating strategies and management expertise.

As of March 31, 2012, one of the quantitative thresholds was triggered, which required our medical office property operating segment to be presented as a separate reportable segment. As such, our medical office properties are presented as a separate reportable segment for the three-month period ended March 31, 2012 as well as for the comparative prior period.

Key Performance Indicators

Our operating results depend primarily upon rental income from our Rental Operations. The following discussion highlights the areas of Rental Operations that we consider critical for future revenues.

Occupancy Analysis

Our ability to maintain high occupancy rates is a principal driver of maintaining and increasing rental revenue. The following table sets forth occupancy information regarding our in-service portfolio of consolidated rental properties, including properties classified within both continuing and discontinued operations, as of March 31, 2012 and 2011 respectively (in thousands, except percentage data):

Type	Total Square Feet 2012	Total Square Feet 2011	Percent of Total Square Feet 2012	Percent of Total Square Feet 2011	Percent Occupied 2012	Percent Occupied 2011
Industrial	91,551	82,252	82.3 %	73.8 %	93.7 %	89.8 %
Office	15,767	26,295	14.2 %	23.6 %	83.8 %	84.6 %
Medical Office	3,076	2,069	2.8 %	1.9 %	90.2 %	86.4 %
Other	823	847	0.7 %	0.7 %	89.2 %	87.6 %
Total	111,217	111,463	100.0 %	100.0 %	92.1 %	88.5 %

Leasing activity and acquisitions within our industrial properties, coupled with significant dispositions of office properties, drove the overall increase in occupancy from March 31, 2011.

Lease Expiration and Renewals

Our ability to maintain and improve occupancy rates primarily depends upon our continuing ability to re-lease expiring space. The following table reflects our consolidated in-service portfolio lease expiration schedule by property type as of March 31, 2012. The table indicates square footage and annualized net effective rents (based on March 31, 2012 rental revenue) under expiring leases (in thousands, except percentage data):

	Total Consolidated Portfolio			Industrial		Office		Medical Office		Other	
Year of Expiration	Square Feet	Ann. Rent Revenue	% of Revenue	Square Feet	Ann. Rent Revenue	Square Feet	Ann. Rent Revenue	Square Feet	Ann. Rent Revenue	Square Feet	Ann. Rent Revenue
Remainder of 2012	4,860	$27,976	5 %	3,835	$15,827	960	$11,151	54	$766	11	$232
2013	15,335	78,465	14 %	13,480	52,446	1,780	24,754	42	599	33	666
2014	12,235	64,652	11 %	10,478	40,653	1,590	21,178	146	2,416	21	405
2015	12,967	65,812	11 %	11,176	43,411	1,740	21,384	27	461	24	556
2016	11,086	58,369	10 %	9,318	34,669	1,666	21,616	81	1,592	21	492
2017	10,676	58,835	10 %	8,984	33,555	1,274	16,718	233	4,471	185	4,091
2018	6,939	51,553	9 %	4,974	19,740	1,397	18,878	366	7,634	202	5,301
2019	5,925	37,127	6 %	4,679	17,467	976	13,050	192	4,196	78	2,414
2020	7,016	41,865	7 %	5,936	23,230	681	10,525	359	7,239	40	871
2021	5,627	34,248	6 %	4,686	18,785	586	7,009	325	7,747	30	707
2022 and Thereafter	9,811	60,055	11 %	8,220	28,173	554	8,960	948	21,320	89	1,602
Total Leased	102,477	$578,957	100 %	85,766	$327,956	13,204	$175,223	2,773	$58,441	734	$17,337
Total Portfolio Square Feet	111,217			91,551		15,767		3,076		823	
Percent Occupied	92.1 %			93.7 %		83.8 %		90.2 %		89.2 %	

Within our consolidated properties, we renewed 83.1% and 69.2% of our leases up for renewal in the three months ended March 31, 2012 and 2011, respectively, totaling more than 2.7 million and approximately 2.9 million square feet, respectively. There was a 2.5% increase in average contractual rents on renewals during the three months ended March 31, 2012 compared to a 7.3% decline in average contractual rents on renewals during the three months ended March 31, 2011.

The average term of renewals was 4.4 years for the three months ended March 31, 2011 compared to 4.6 years for the three months ended March 31, 2012.

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Acquisition and Disposition Activity

For the three months ended March 31, 2012, we acquired seven properties and other real estate-related assets with a total acquisition-date value of $153.1 million. For the three months ended March 31, 2011, we acquired 13 properties for $132.2 million, which represented continued activity in our acquisition of a portfolio of buildings in South Florida (the "Premier Portfolio"), of which the initial 39 properties were acquired on December 30, 2010.

Net cash proceeds related to the dispositions of wholly owned buildings and undeveloped land totaled $63.3 million and $437.5 million for the three months ended March 31, 2012 and 2011, respectively. Included in the wholly owned building dispositions in the three months ended March 31, 2011 is the sale of 13 suburban office properties for net proceeds of $273.7 million, totaling approximately 2.0 million square feet, to a joint venture in which we own 20%.

We regularly work to identify, consider and pursue opportunities to acquire and dispose of properties on an opportunistic basis and on a basis that is generally consistent with our strategic plans.

Development

At March 31, 2012, we had 2.4 million square feet of property under development with total estimated costs upon completion of $349.0 million compared to 3.4 million square feet with total costs