

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

MISSION WEST PROPERTIES INC
Form 10-K/A
November 07, 2005

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Amendment No. 1
To Form 10-K on
FORM 10-K/A

(Mark One)

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

For Fiscal Year Ended: December 31, 2004

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 No. 1-8383

MISSION WEST PROPERTIES, INC.

(Exact name of registrant as specified in its charter)

Maryland

95-2635431

(State or other jurisdiction of
Incorporation or organization)

(I.R.S. Employer
Identification Number)

10050 Bandley Drive, Cupertino CA
(Address of principal executive offices)

95014
(Zip Code)

Registrant's telephone number, including area code: (408) 725-0700

Securities Registered Pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, par value \$.001 per share	American Stock Exchange Pacific Exchange, Inc.

Securities Registered Pursuant to Section 12(g) of the Act:

NONE

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

Form 10-K. [X]

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes [X] No []

The aggregate market value of the voting stock held by non-affiliates of the Registrant, based upon the closing sale price of the Common Stock on June 30, 2004, as reported on the American Stock Exchange, was approximately \$218,751,298. As of February 28, 2005, there were 18,097,191 shares of the Registrant's Common Stock outstanding.

Documents Incorporated By Reference

Portions of Mission West Properties, Inc.'s Proxy Statement for the 2005 annual meeting of stockholders, a definitive copy of which will be filed with the SEC within 120 days after the year end of the year covered by this Form 10-K, are incorporated by reference herein as portions of Part III of this Form 10-K.

EXPLANATORY NOTE

This amendment to the Form 10-K of Mission West Properties, Inc. is filed solely to amend the certifications of the Chief Executive Officer, Chief Operating Officer and Vice President of Finance pursuant to SEC Rule 13a-14(a), which are filed exhibits 31.1, 31.2 and 31.3 under Item 601(b)(31) of Regulation S-K. No other portion of the report on Form 10-K as originally filed is being modified by this amendment.

- i -

FORWARD LOOKING INFORMATION

This annual report contains forward-looking statements within the meaning of the federal securities laws. We intend such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995, and are including this statement for purposes of complying with these safe harbor provisions. Forward-looking statements include our discussion of "Quantitative and Qualitative Disclosures about Market Risks" in Item 7A below. Forward-looking statements, which are based on certain assumptions and describe future plans, strategies and expectations of us, are generally identifiable by use of the words "believe," "expect," "intend," "anticipate," "estimate," "project" or similar expressions. Our ability to predict results or the actual effect of future plans or strategies is inherently uncertain. Factors which could have a material adverse effect on the operations and future prospects of the Company include, but are not limited to, changes in: economic conditions generally and the real estate market specifically, legislative or regulatory provisions affecting the Company (including changes to laws governing the taxation of Real Estate Investment Trusts ("REITs")), availability of capital, interest rates, competition, supply of and demand for office and industrial properties in our current and proposed market areas, tenant defaults and bankruptcies, and general accounting principles, policies and guidelines applicable to REITs. In addition, the actual timing of development, construction, and leasing on the projects that the Company believes it may acquire in the future under the Berg Land Holdings Option Agreement is unknown presently. These risks and uncertainties, together with the other risks described from time to time in our reports and documents filed with the Securities and Exchange Commission, should be considered in evaluating forward-looking statements and undue reliance should not be placed on

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

such statements. See Part I, Item 1, "Risk Factors."

- ii -

MISSION WEST PROPERTIES, INC. 2004 FORM 10-K ANNUAL REPORT

Table of Contents

PART I

Item 1.	Business
Item 2.	Properties
Item 3.	Legal Proceedings
Item 4.	Submission of Matters to a Vote of Security Holders

PART II

Item 5.	Market for the Registrant's Common Equity and Related Stockholder Matters
Item 6.	Selected Financial Data
Item 7.	Management's Discussion and Analysis of Financial Condition and Results of Operations
Item 7A.	Quantitative and Qualitative Disclosures about Market Risk
Item 8.	Consolidated Financial Statements and Supplementary Data
Item 9.	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure
Item 9A.	Controls and Procedures
Item 9B.	Other Information

PART III

Item 10.	Directors and Executive Officers of the Registrant
Item 11.	Executive Compensation
Item 12.	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters
Item 13.	Certain Relationships and Related Transactions
Item 14.	Principal Accountant Fees and Services

PART IV

Item 15.	Exhibits, Financial Statements, Schedules and Reports on Form 8-K Signatures
----------	--

- iii -

PART I

ITEM 1. BUSINESS

ORGANIZATION AND GENERAL BUSINESS DESCRIPTION

Mission West Properties, Inc. (the "Company") acquires, markets, leases, and manages research and development ("R&D") properties, primarily located in the Silicon Valley portion of the San Francisco Bay Area. As of December

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

31, 2004, we owned and managed 109 properties totaling approximately 7.9 million rentable square feet of R&D properties through four limited partnerships, or operating partnerships, for which we are the sole general partner. R&D property is designed for research and development and office uses and, in some cases, includes space for light manufacturing operations with loading docks. We believe that we have one of the largest portfolios of R&D properties in the Silicon Valley. There are six tenants who individually lease in excess of 300,000 rentable square feet from us: Microsoft Corporation, Fujitsu America (a subsidiary of Fujitsu Limited), JDS Uniphase Corporation, NEC Electronics America, Inc. (a subsidiary of NEC Electronics Corporation), Ciena Corporation and Apple Computer, Inc. For federal income tax purposes we have operated as a self-managed, self-administered and fully integrated Real Estate Investment Trust ("REIT") since fiscal 1999.

Prior to July 1, 1998, most of our properties were under the ownership or control of Carl E. Berg, his brother Clyde J. Berg, certain members of their respective immediate families, and certain entities in which Carl E. Berg and/or Clyde J. Berg held controlling or other ownership interests (the "Berg Group"). We acquired these properties as of July 1, 1998 by becoming the general partner of each of the four operating partnerships in an UPREIT transaction. At that time, we also acquired ten properties comprising approximately 560,000 rentable square feet from entities controlled by third parties in which the Berg Group members were significant owners.

Through various property acquisition agreements with the Berg Group and subject to the approval of the Independent Directors Committee of the Board of Directors, we have the right to purchase, on pre-negotiated terms, R&D and other types of office and light industrial properties that the Berg Group develops in the future. With in-house development, architectural and construction personnel, the Berg Group continues to focus on a full range of land acquisition, development and construction activities for R&D properties, often build-to-suit, to meet the demands of Silicon Valley information technology companies. As the developer, the Berg Group takes on the risks of purchasing the land, obtaining regulatory approvals and permits and financing construction. Since September 1998, we have acquired approximately 3,135,000 additional rentable square feet of R&D properties from the Berg Group under these agreements.

OUR RELATIONSHIP WITH THE BERG GROUP

Through a series of transactions occurring between May 1997 and December 1998, we became the vehicle for substantially all of the Silicon Valley R&D property operating activities of the Berg Group. We are the general partner pursuant to the partnership agreements of the operating partnerships and, along with members of the Berg Group and other individuals, are party to an Exchange Rights Agreement and the Berg Land Holdings Option Agreement. Each agreement defines the material rights and obligations among us, the Berg Group members, and other parties to those agreements. Among other things, these agreements give us rights to:

- control the operating partnerships;
- acquire, subject to approval of the Independent Directors Committee of the Board of Directors, on pre-negotiated terms, all future R&D properties developed by the Berg Group on land currently owned or acquired in the future; and
- acquire R&D, office and industrial properties identified by the Berg Group in California, Oregon and Washington, subject to approval of the Independent Directors Committee of the Board of Directors.

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

Under these agreements, our charter or our bylaws, the Berg Group has the right to:

- designate two of five nominees for director to be elected by our stockholders, subject to the Berg Group's maintenance of certain ownership interests;
- participate in our securities offerings;
- exchange their operating partnership interests ("O.P. Units") for shares of our common stock;

- 1 -

- vote on major transactions, subject to its maintenance of certain ownership interests; and
- prevent us from selling properties when the sale will have adverse tax consequences to the Berg Group members.

To comply with REIT requirements that restrict the percentage of the total value of our stock that may be owned by five or fewer individuals to 50% or less, our charter generally prohibits the direct or indirect ownership of more than 9% of our common stock by any stockholder. This limit excludes the Berg Group, which has an aggregate ownership limit of 20%. Currently, the Berg Group members collectively own less than 1% of the outstanding shares of our common stock.

Carl E. Berg, the Company's Chairman of the Board of Directors and Chief Executive Officer and the controlling member of the Berg Group, has been engaged in the development and long-term ownership of Silicon Valley real estate in excess of 35 years, most recently through Berg & Berg Enterprises ("Berg & Berg"). In 1969, Mr. Berg foresaw the rising demand for efficient, multi-purpose facilities for the rapidly growing information technology industry in the Silicon Valley. Since 1972, in addition to his real estate activities, Mr. Berg also has been actively involved in venture capital investments in many information technology companies in the Silicon Valley, including such companies as Amdahl Corporation, Sun Microsystems, Inc., and Integrated Device Technologies, Inc. He serves on the board of directors of numerous information technology companies. These activities have helped Mr. Berg develop a detailed understanding of the real estate requirements of information technology companies, acquire valuable market information and increase his name recognition within the venture capital and entrepreneurial communities. These activities also manifest his commitment to the growth and success of Silicon Valley companies. We believe that Mr. Berg's substantial knowledge of and contacts in the information technology industry provide a significant benefit to the Company.

BUSINESS STRATEGY

Our acquisition, growth and operating strategy incorporates the following elements:

- working with the Berg Group to take advantage of their abilities and resources to pursue development opportunities which we have an option to acquire, on pre-negotiated terms, upon completion and leasing;
- capitalizing on opportunistic acquisitions from third parties of high-quality R&D properties that provide attractive initial yields and

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

significant potential for growth in cash-flow;

- focusing on general purpose, single-tenant Silicon Valley R&D properties for information technology companies in order to maintain low operating costs, reduce tenant turnover and capitalize on our relationships with these companies and our extensive knowledge of their real estate needs; and
- maintaining prudent financial management principles that emphasize current cash flow while building long-term value, the acquisition of pre-leased properties to reduce development and leasing risks and the maintenance of sufficient liquidity to acquire and finance properties on desirable terms.

ACQUIRING PROPERTIES DEVELOPED BY THE BERG GROUP

We anticipate that most of our growth, if any, in rentable square footage in the foreseeable future will come from the acquisition of new R&D properties that are either currently under development or to be developed in the future by the Berg Group. The Berg Land Holdings Option Agreement gives us the right to acquire future R&D property developments by the Berg Group on up to 84 additional acres of land currently controlled by the Berg Group, which could support approximately 1.4 million square feet of new developments. Nevertheless, at this time we do not anticipate acquiring any additional newly constructed R&D properties from the Berg Group for several years because of the current market conditions in the Silicon Valley.

In light of this overcapacity in the market, the Berg Group currently is seeking local government approval of a proposed rezoning of the 160-acre Evergreen site to permit residential development on a substantial portion of the site. The Independent Directors Committee, which is responsible for reviewing, evaluating and authorizing action with respect to any transaction between us and any member of the Berg Group, has authorized removal of the Evergreen site from the scope of the Berg Land Holdings Option Agreement, subject to the completion of the rezoning of the 160-acre Evergreen site, or portion thereof, for residential development. In making this determination, the Independent Directors Committee considered a number of factors, including risks and other potentially adverse consequences that could be associated with large scale residential development activities. Any portion of the Evergreen site that is not rezoned as residential property is not deemed to be removed from the scope of the Berg Land Holdings Option Agreement and would remain eligible for potential future acquisition under the Berg Land Holdings Option Agreement.

- 2 -

BERG LAND HOLDINGS OPTION AGREEMENT. We believe that control of high quality, developable land is an important strategic factor for continued success in the Silicon Valley market. In December 1998, we entered into the Berg Land Holdings Option Agreement under which we have an option to purchase all land acquired, directly or indirectly, by Carl E. Berg or Clyde J. Berg that has not been improved with completed buildings and which is zoned, intended or appropriate for R&D, office and/or industrial development or use in the states of California, Oregon and Washington. In addition, Carl E. Berg has agreed not to directly or indirectly acquire or develop any real property zoned for office, industrial or R&D use in the states of California, Oregon and Washington without first disclosing and making the acquisition opportunity available to us. Our Independent Directors Committee decides whether we will pursue each opportunity presented to us by Mr. Berg. This restriction will expire when there is no Berg Group nominee on our board of directors and the Berg Group's fully

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

diluted ownership percentage, which is calculated based on all outstanding shares of common stock and all shares of common stock that could be acquired upon the exercise of all outstanding options to acquire our voting stock, as well as all shares of common stock issuable upon exchange of all O.P. Units ("Fully Diluted"), falls below 25%.

As of December 31, 2004, we had acquired 20 leased R&D properties totaling approximately 1,992,000 rentable square feet under this agreement at a cost of approximately \$205.2 million, for which we issued 7,933,849 O.P. Units and assumed debt of approximately \$118 million. The principal terms of the agreement include the following:

- So long as the Berg Group members and their affiliates own or have the right to acquire shares representing at least 65% of our common stock on a Fully Diluted basis, we will have the option to acquire any building developed by any member of the Berg Group on the land subject to the Berg Land Holdings Option Agreement at such time as the building has been leased. Upon our exercise of the option, the option price will equal the sum of the following or a lesser amount as approved by the Independent Directors Committee:
 1. the full construction cost of the building; plus
 2. 10% of the full construction cost of the building; plus
 3. interest at LIBOR plus 1.65%, on the amount of the full construction cost of the building for the period from the date funds were disbursed by the developer to the close of escrow; plus
 4. the original acquisition cost of the parcel on which the improvements will be constructed, which range from \$8.50 to \$20.00 per square foot for land currently owned or under option; plus
 5. 10% per annum of the amount of the original acquisition cost of the parcel from the later of January 1, 1998 and the seller's acquisition date, to the close of escrow; minus
 6. the aggregate principal amount of all debt encumbering the acquired property.
- The acquisition cost, net of any debt, will be payable in cash, or O.P. Units valued at the average closing price of our common stock over the 30-trading-day period preceding the acquisition or, in cash, at the option of the Berg Group.
- We also must assume all property tax assessments.
- If we elect not to exercise the option with respect to any property, the Berg Group may hold and lease the property for its own account, or may sell it to a third party.
- All action taken by us under the Berg Land Holdings Option Agreement, including any variations from stated terms outlined above must be approved by a majority of the members of the Independent Directors Committee of our Board of Directors.

As a general policy which has been established by the Independent Directors Committee, we do not acquire properties under the Berg Land Holdings Option Agreement until they have been leased. We are responsible for a significant portion of the leasing process in connection with such acquisitions, however.

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

The following table presents certain information concerning currently identified land that we have the right to acquire under the Berg Land Holdings Option Agreement.

Property	Net Acres	Approximate Rentable Area (Square Feet)

Available Land:		
Piercy & Hellyer	30	490,000
Morgan Hill (1)	18	288,025
King Ranch	12	207,000
Fremont & Cushing	24	387,000

Total	84	1,372,025
=====		

- (1) We expect to own an approximate 50% interest in the partnership through one of our operating partnerships. The property will be operated and managed by the other joint venture partner in the entity.

Although we expect to acquire new properties or joint ventures available to us under the terms of the Berg Land Holdings Option Agreement, subsequent to the approval by the Independent Directors Committee of our Board of Directors, there can be no assurance that we actually will consummate any of the intended transactions. Furthermore, we have not yet determined the means by which we would acquire and pay for any such properties or the impact of any of the acquisitions on our business, results of operations, financial condition, Funds From Operation ("FFO") or available cash for distribution. See Item 1, "Risk Factors - Our contractual business relationships with the Berg Group present additional conflicts of interest which may result in the realization of economic benefits or the deferral of tax liabilities by the Berg Group without equivalent benefits to our stockholders."

Given the downturn in the Silicon Valley real estate market for R&D/office properties, we may not be able to maintain historical levels of growth from acquisitions of new developments in the future.

OPPORTUNISTIC ACQUISITIONS

In addition to our principal opportunities under the Berg Land Holdings Option Agreement, we believe our acquisitions experience, established network of real estate and information technology professionals, and overall financial condition will continue to provide opportunities for external growth. In general, we will seek opportunistic acquisitions of high quality, well located Silicon Valley R&D properties in situations where illiquidity or inadequate management permit their acquisition at favorable prices, and where our management skills and knowledge of Silicon Valley submarkets may facilitate increases in cash flow and asset value. Furthermore, our use of the operating partnership structure allows us to offer prospective sellers the opportunity to contribute properties on a tax-deferred basis in exchange for O.P. Units. Although we have not consummated any transactions like this since our July 1, 1998 acquisition of the Berg Group properties, this capacity to complete tax-deferred transactions with sellers of real property further enhances our ability to acquire additional properties.

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

FOCUS ON SINGLE TENANT SILICON VALLEY R&D Properties

We intend to continue to emphasize the acquisition of single-tenant rather than multi-tenant properties, a practice that has historically contributed to the relatively low turnover and high occupancy rates on our properties. We believe that the relatively small number of tenants (79) occupying our 109 properties, mostly under the triple net lease structure, allows us to efficiently manage the properties and to serve our tenants' needs without extensive in-house staff or the assistance of a third-party property management organization. In addition, this emphasis allows us to incur less expense for tenant improvements and leasing commissions than multi-tenant, high turnover property owners. This strategy also reduces the time and expense associated with obtaining building permits and other governmental approvals. We believe that the relatively stable, extended relationships that we have developed with our key tenants are valuable in the expansion of our business.

- 4 -

RECENT RENTAL MARKET DEVELOPMENTS AND THEIR IMPACT ON OUR BUSINESS

All of the Company's properties are located in the Northern California area known as Silicon Valley, which generally consists of portions of Santa Clara County, Southwestern Alameda County, Southeastern San Mateo County and Eastern Santa Cruz County. The Silicon Valley economy and business activity slowed markedly during 2001 through 2004 after fast-paced growth in 1999 and 2000. In the past several years, the Silicon Valley R&D property market has fluctuated with the local economy. According to a recent report by BT Commercial Real Estate, vacancy rates for Silicon Valley R&D property increased from approximately 22.05% in late 2003 to 22.38% at the end of 2004. Total vacant R&D square footage in Silicon Valley at the end of the fourth quarter of 2004 amounted to 34.65 million square feet, of which 26.6%, or 9.2 million square feet, was sublease space. Total negative net absorption (which is the computation of gross square footage leased less gross new square footage vacated for the period presented) in 2003 amounted to approximately (4.0) million square feet. For the year 2004, total negative net absorption declined to approximately (0.3) million square feet as local economic conditions improved, but the overall R&D property market did not recover. The impact of vacancies has not been uniform throughout the area, however. The Silicon Valley R&D property market is characterized by a substantial number of submarkets, with rent and vacancy rates varying by submarket and location within each submarket. In addition, the time to complete the marketing and lease up of vacant space has increased from an average of several months to as much as an average of 12 to 24 months as a result of the increased vacancy in the market.

For the years ended December 31, 2004 and 2003, average occupancy in our portfolio was 71.7% and 80.5%, respectively. Prior to the first quarter of 2002, we had achieved historical average occupancy levels of above 98% since 1999. We believe that maintaining average occupancy levels above 98% will not be sustainable given the current economic environment, as evidenced by our occupancy level of 70.7% at December 31, 2004.

Although we scrutinize each prospective tenant's creditworthiness and continually evaluate the financial capacity of both our prospective and existing tenants, a downturn in tenants' businesses may weaken tenants' financial conditions and could result in defaults under their lease obligations. We believe that the average 2005 renewal rental rates for our

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

properties will be approximately equal to, or perhaps, below current market rents. In addition, leasing activity for new build-to-suit and vacated R&D properties has slowed considerably during the past several years. Leases representing approximately 501,000 square feet, or 4.7% of our 2005 cash rent, are scheduled to expire during 2005. If we are unable to lease a significant portion of any vacant space or space scheduled to expire; if we experience significant tenant defaults as a result of the current economic downturn; or if we are not able to lease space at or above current market rates, our results of operations and cash flows will be adversely affected.

OPERATIONS

We operate as a self-administered, self-advised and self-managed REIT with our own employees. Generally, as the sole general partner of the operating partnerships, we control the business and assets of the operating partnerships and have full and complete authority, discretion and responsibility with respect to the operating partnerships' operations and transactions, including, without limitation, acquiring additional properties, borrowing funds, raising new capital, leasing buildings and selecting and supervising all agents of the operating partnerships.

Although most of our leases are triple net and building maintenance and tenant improvements are the responsibility of the tenants, from time to time we may be required to undertake construction and repair work at our properties. We will bid all major work competitively to subcontractors. Members of the Berg Group may participate in the competitive bidding for the work.

We generally will market the properties and negotiate leases with tenants ourselves. We make the availability of our properties known to the brokerage community to garner their assistance in locating prospective tenants. As a result, we expect to retain our policy of paying fixed commissions to tenants' brokers.

We believe that our business practices provide us with competitive advantages, including -

- EXTERNAL DEVELOPMENT AFFILIATE. We have the option to purchase all future R&D, office, industrial property developments of the Berg Group under the Berg Land Holdings Option Agreement on land currently held or acquired directly or indirectly by Carl E. Berg or Clyde J. Berg that is zoned for those purposes and located in California, Oregon and Washington following completion and lease-up of the property. The acquisition terms and conditions for the existing and identified projects have been pre-negotiated and are documented under the Berg Land Holdings Option Agreement. This relationship provides us with the economic benefits of development while eliminating development

- 5 -

and initial lease-up risks. It also provides us with access to one of the most experienced development teams in the Silicon Valley without the expense of maintaining development personnel.

- LEAN ORGANIZATION, EXPERIENCED TEAM. In part because of our primary focus on Silicon Valley, our experience with the special real estate requirements of information technology tenants and the long-term triple-net structure of our leases, we are able to conduct and expand our business with a small management team comprised of highly qualified and experienced professionals working within a relatively

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

flat organizational structure. We believe that the leanness of our organization and our experience will enable us to rapidly assess and respond to market opportunities and tenant needs, control operating expenses and develop and maintain excellent relationships with tenants. We further believe that these advantages translate into significantly lower costs for operations and give us the ability, along with the Berg Group, to compete favorably with other R&D property developers in Silicon Valley, especially for build-to-suit projects subject to competitive bidding. Furthermore, we believe this lower cost structure allows us to generate better returns from properties whose value can be increased through appropriate remodeling and efficient property management.

- SOUND PROPERTY MANAGEMENT PRACTICES. For each property, the management team, along with the Berg Group staff, develops a specific marketing and property management program. We select vendors and subcontractors on a competitive bid basis from a select group of highly qualified firms with whom we maintain ongoing relationships and carefully supervise their work.

OPERATING PARTNERSHIP AGREEMENTS

MANAGEMENT

The operating partnerships consist of four separate limited partnerships engaged in the combined operation and ownership of all our properties. The operating partnership agreements are identical in all material respects for all four of the limited partnerships. Pursuant to the operating partnership agreements, we act as the sole general partner of the operating partnerships, in which capacity we have exclusive control of the business and assets of the operating partnerships and generally have full and complete authority, discretion and responsibility with respect to the operating partnerships' operations and transactions, including, without limitation, acquisitions of additional properties, borrowing funds, raising new capital, leasing buildings, as well as selecting and supervising all employees and agents of the operating partnerships. Through our authority to manage our business and affairs, our Board of Directors directs the business of the operating partnerships.

Notwithstanding our effective control of the operating partnerships, the Berg Group holds a substantial majority of the outstanding O.P. Units and the consent of the limited partners holding a majority of the outstanding O.P. Units is required with respect to certain extraordinary actions involving the operating partnerships, including:

- the amendment, modification or termination of the operating partnership agreements;
- a general assignment for the benefit of creditors or the appointment of a custodian, receiver or trustee for any of the assets of the operating partnerships;
- the institution of any proceeding for bankruptcy of the operating partnerships;
- the transfer of any general partnership interests in the operating partnerships, including, with certain exceptions, transfers attendant to any merger, consolidation or liquidation of our corporation;
- the admission of any additional or substitute general partner in the operating partnerships; and

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

- a change of control of the operating partnerships.

In addition, until the ownership interest of the Berg Group and its affiliates is less than 15% of the common stock on a Fully Diluted basis, the consent of the limited partners holding a majority of the outstanding O.P. Units is also required with respect to:

- the liquidation of the operating partnerships;
- the sale or other transfer of all or substantially all of the assets of the operating partnerships and certain mergers and business combinations resulting in the complete disposition of all O.P. Units; and
- the issuance of limited partnership interests having seniority as to distributions, assets and voting over the O.P. Units.

- 6 -

TRANSFERABILITY OF O.P. UNITS

The operating partnership agreements provide that the limited partners may transfer their O.P. Units, subject to certain limitations. Except for certain transfers by the limited partners to or from certain of their affiliates, however, all transfers may be made only with our prior written consent as the sole general partner of the operating partnerships.

In addition, no transfer of O.P. Units by the limited partners may be made in violation of certain regulatory and other restrictions set forth in the operating partnership agreements. Except in the case of certain permitted transfers to or from certain affiliates of the limited partners, the exchange rights, the put rights, rights to participate in future equity financings and provisions requiring the approval of certain limited partners for certain matters will no longer be applicable to O.P. Units so transferred, and the transferee will not have any rights to nominate persons to our Board of Directors.

ADDITIONAL CAPITAL CONTRIBUTIONS AND LOANS

Each operating partnership agreement provides that, if the operating partnership requires additional funds to pursue its investment objectives, we may fund such investments by raising additional equity capital and making a capital contribution to the operating partnerships or by borrowing such funds and lending the net proceeds of such loans to the operating partnerships. If we intend to provide additional funds through a contribution to capital and purchase of units of general partnership interest, the limited partners will have the right to participate in such funding on a pro rata, pari passu basis and to acquire additional O.P. Units. If the limited partners do not participate in such financing, we will acquire additional units of general partnership interest. In either case, the number of additional units of partnership interest will be increased based upon the amount of the additional capital contributions and the value of the operating partnerships as of the date such contributions are made.

In addition, as general partner of the operating partnerships, we have the ability to cause the operating partnerships to issue additional O.P. Units. In the event that the operating partnerships issue new O.P. Units for cash but not property, the limited partners will have the right to purchase new O.P. Units at the price we offer in the transaction giving rise to such participation right in order, and to the extent necessary, to maintain

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

their respective percentage interests in the operating partnerships.

EXCHANGE RIGHTS, PUT RIGHTS AND REGISTRATION RIGHTS

Under the Exchange Rights Agreement between us and the limited partners, the limited partners have exchange rights that generally became exercisable on December 29, 1999. The Exchange Rights Agreement permits every limited partner to tender O.P. Units to us, and, at our election, to receive common stock on a one-for-one basis at then-current market value, an equivalent amount of cash, or a combination of cash and common stock in exchange for the O.P. Units tendered, subject to the 9% overall ownership limit imposed on non-Berg Group stockholders under our charter document, or the overall 20% Berg Group ownership limit, as the case may be. For more information, please refer to this Item 1, "Risk Factors - Failure to satisfy federal income tax requirements for REITs could reduce our distributions, reduce our income and cause our stock price to fall." This exchange ratio is subject to adjustment for stock splits, stock dividends, recapitalizations of our common stock and similar types of corporate actions. In addition, once in each 12-month period beginning each December 29, the limited partners, other than Carl E. Berg and Clyde J. Berg, may exercise a put right to sell their O.P. Units to the operating partnerships at a price equal to the average market price of the common stock for the 10-trading day period immediately preceding the date of tender. Upon any exercise of the put rights, we will have the opportunity for a period of 15 days to elect to fund the purchase of the O.P. Units and purchase additional general partner interests in the operating partnerships for cash, unless the purchase price exceeds \$1 million in the aggregate for all tendering limited partners, in which case, the operating partnerships or we will be entitled to reduce proportionally the number of O.P. Units to be acquired from each tendering limited partner so that the total purchase price is not more than \$1 million.

The shares of our common stock issuable in exchange for the O.P. Units outstanding at July 1, 1998 and the O.P. Units issued pursuant to the Pending Projects Acquisition Agreement were registered under the Securities Act and generally may be sold without restriction if they are acquired by limited partners that are not affiliates, as defined under SEC Rule 144. For more information please refer to this Item 1, "Risk Factors - Shares eligible for future sale could affect the market price of our stock." The Exchange Rights Agreement gives the holders of O.P. Units the right to participate in any registered public offering of the common stock initiated by us to the extent of 25% of the total shares sold in the offering upon converting O.P. Units to shares of common stock, but subject to the underwriters' unlimited right to reduce the participation of all selling stockholders. The holders of O.P. Units will be able to request resale registrations of shares of common stock acquired on exchange of O.P. Units on a Form S-3, or any equivalent form of registration statement. We are obligated to effect no more than two such registrations in any 12-month period. We are obligated to assist the O.P. Unit holders in obtaining a firm commitment underwriting agreement for such resale from a qualified investment-banking firm. If registration on Form S-3, or an equivalent form, is not available for any reason, we will be obligated to effect a registration of the shares to be acquired on exercise of the exchange rights on Form S-11, or an equivalent form, in an underwritten public offering, upon demand by the

- 7 -

holders of no fewer than 500,000 O.P. Units. All holders of O.P. Units will be entitled to participate in such registration. We will bear all costs of such registrations other than selling expenses, including commissions and

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

separate counsels' fees of the O.P. Unit holders. We will not be required to affect any registration for resale on Form S-3, or equivalent form of common stock shares issuable to the holder of O.P. Units if the request is for less than 250,000 shares.

OTHER MATTERS

The operating partnership agreements require that the operating partnerships be operated in a manner that will enable us to satisfy the requirements for being classified as a REIT and to avoid any federal income or excise tax liability.

The operating partnership agreements provide that the combined net operating cash flow from all the operating partnerships, as well as net sales and refinancing proceeds, will be distributed from time to time as determined by our Board of Directors, but not less frequently than quarterly, pro rata in accordance with the partners' percentage interests in the operating partnerships, taken as a whole. This provision is intended to cause the periodic distributions per O.P. Unit and per share of our common stock to be equal. As a consequence of this provision, the capital interest of a partner in each of the operating partnerships, including our capital interests, might at times differ significantly from the partner's percentage interest in the net income and cash flow of that operating partnership. We do not believe that such differences would have a material impact on our business, financial condition or funds available for distributions, however.

Pursuant to the operating partnership agreements, the operating partnerships will also assume and pay when due, or reimburse us for payment of, certain costs and expenses relating to our continuity of existence and operations.

The operating partnership agreements provide that, upon the exercise of an outstanding option under the 1997 Stock Option Plan, we may purchase additional general partner interests in the operating partnerships by contributing the exercise proceeds to the operating partnerships. Our increased interest shall be equal to the percentage of outstanding shares of common stock and O.P. Units on an as-converted basis represented by the shares acquired upon exercise of the option.

TERM

The operating partnerships will continue in full force and effect until December 31, 2048 or until sooner dissolved pursuant to the terms of the operating partnership agreements.

EMPLOYEES

As of February 28, 2005, we employed five people, all of whom work at our executive offices at 10050 Bandley Drive, Cupertino, California, 95014.

FACILITIES

We lease office space at 10050 Bandley Drive, Cupertino, California from Berg & Berg Enterprises, Inc. and share clerical staff and other overhead on what we consider to be favorable terms. The total monthly rent payable by us to Berg & Berg Enterprises, Inc. is \$7,520.

RISK FACTORS

YOU SHOULD CAREFULLY CONSIDER THE FOLLOWING RISKS, TOGETHER WITH THE OTHER INFORMATION CONTAINED ELSEWHERE IN THIS FORM 10-K. THE FOLLOWING RISKS

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

RELATE PRINCIPALLY TO OUR BUSINESS AND THE INDUSTRY IN WHICH WE OPERATE. THE RISKS AND UNCERTAINTIES CLASSIFIED BELOW ARE NOT THE ONLY ONES WE FACE.

WE ARE DEPENDENT ON CARL E. BERG, AND IF WE LOSE HIS SERVICES OUR BUSINESS MAY BE HARMED AND OUR STOCK PRICE COULD FALL.

We are substantially dependent upon the leadership of Carl E. Berg, our Chairman and Chief Executive Officer. Losing Mr. Berg's knowledge and abilities could have a material adverse effect on our business and the value of our common stock. Mr. Berg manages our day-to-day operations and devotes a significant portion of his time to our affairs, but he has a number of other business interests as well. These other activities reduce Mr. Berg's attention to our business.

- 8 -

MR. BERG AND HIS AFFILIATES EFFECTIVELY CONTROL OUR CORPORATION AND THE OPERATING PARTNERSHIPS AND MAY ACT IN WAYS THAT ARE DISADVANTAGEOUS TO OTHER STOCKHOLDERS.

SPECIAL BOARD VOTING PROVISIONS. Our governing corporate documents, which are our articles of amendment and restatement, or charter, and our bylaws, provide substantial control rights for the Berg Group. The Berg Group's control of our corporation means that the value and returns from an investment in the Company's common stock are subject to the Berg Group's exercise of its rights. These rights include a requirement that Mr. Berg or his designee as director approve certain fundamental corporate actions, including amendments to our charter and bylaws and any merger, consolidation or sale of all or substantially all of our assets. In addition, our bylaws provide that a quorum necessary to hold a valid meeting of the Board of Directors must include Mr. Berg or his designee. The rights described in the two preceding sentences apply only as long as the Berg Group members and their affiliates, other than us and the operating partnerships, beneficially own, in the aggregate, at least 15% of our outstanding shares of common stock on a Fully Diluted basis. Also, directors representing more than 75% of the entire Board of Directors must approve other significant transactions, such as incurring debt above certain amounts and conducting business other than through the operating partnerships. Without the approval of Mr. Berg or his designee, the Board of Directors' approval that we may need for actions that might result in a sale of your stock at a premium or raising additional capital when needed could be difficult or impossible to obtain.

BOARD OF DIRECTORS REPRESENTATION. The Berg Group members have the right to designate two of the director nominees submitted by our Board of Directors to stockholders for election, as long as the Berg Group members and their affiliates, other than us and the operating partnerships, beneficially own, in the aggregate, at least 15% of our outstanding shares of common stock calculated on a Fully Diluted basis. If the Fully Diluted ownership of the Berg Group members and their affiliates, other than us and the operating partnerships, is less than 15% but is at least 10% of the common stock, the Berg Group members have the right to designate one of the director nominees submitted by our Board of Directors to stockholders for election. Its right to designate director nominees affords the Berg Group substantial control and influence over the management and direction of our corporation. The Berg Group's interests could conflict with the interests of our stockholders and could adversely affect the price of our common stock.

SUBSTANTIAL OWNERSHIP INTEREST. The Berg Group currently owns O.P. Units

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

representing approximately 74.2% of the equity interests in the operating partnerships and approximately 74.2% of our equity interests on a Fully Diluted basis. The O.P. Units may be converted into shares of common stock, subject to limitations set forth in our charter and other agreements with the Berg Group, and upon conversion would represent voting control of our corporation. The Berg Group's ability to exchange its O.P. Units for common stock permits it to exert substantial influence over the management and direction of our corporation. This influence increases our dependence on the Berg Group.

LIMITED PARTNER APPROVAL RIGHTS. Mr. Berg and other limited partners, including other members of the Berg Group, may restrict our operations and activities through rights provided under the terms of the amended and restated agreement of limited partnership which governs each of the operating partnerships and our legal relationship to each operating partnership as its general partner. Matters requiring approval of the holders of a majority of the O.P. Units, which necessarily would include the Berg Group, include the following:

- the amendment, modification or termination of any of the operating partnership agreements;
- the transfer of any general partnership interest in the operating partnerships, including, with certain exceptions, transfers attendant to any merger, consolidation or liquidation of our corporation;
- the admission of any additional or substitute general partners in the operating partnerships;
- any other change of control of the operating partnerships;
- a general assignment for the benefit of creditors or the appointment of a custodian, receiver or trustee for any of the assets of the operating partnerships; and
- the institution of any bankruptcy proceeding for any operating partnership.

In addition, as long as the Berg Group members and their affiliates, other than us and the operating partnerships, beneficially own, in the aggregate, at least 15% of the outstanding shares of common stock on a Fully Diluted basis, the consent of the limited partners holding the right to vote a majority of the total number of O.P. Units outstanding is also required with respect to:

- 9 -

- the sale or other transfer of all or substantially all of the assets of the operating partnerships and certain mergers and business combinations resulting in the complete disposition of all O.P. Units;
- the issuance of limited partnership interests senior to the O.P. Units as to distributions, assets and voting; and
- the liquidation of the operating partnerships.

The liquidity of an investment in the Company's common stock, including our ability to respond to acquisition offers, will be subject to the exercise of these rights.

OUR CONTRACTUAL BUSINESS RELATIONSHIPS WITH THE BERG GROUP PRESENT ADDITIONAL CONFLICTS OF INTEREST, WHICH MAY RESULT IN THE REALIZATION OF

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

ECONOMIC BENEFITS OR THE DEFERRAL OF TAX LIABILITIES BY THE BERG GROUP WITHOUT EQUIVALENT BENEFITS TO OUR STOCKHOLDERS.

Our contracts with the Berg Group provide it with interests that could conflict with those of our other stockholders, including the following:

- our headquarters are leased from an entity owned by the Berg Group, to whom we pay rent of \$7,520 per month;
- the Berg Group is permitted to conduct real estate and business activities other than our business;
- if we decline an opportunity that has been offered to us, the Berg Group may pursue it, which would reduce the amount of time that Mr. Berg could devote to our affairs and could result in the Berg Group's development of properties that compete with our properties for tenants;
- in general, we have agreed to limit the liability of the Berg Group to our corporation and our stockholders arising from the Berg Group's pursuit of these other opportunities;
- we acquired most of our properties from the Berg Group on terms that were not negotiated at arm's length and without many customary representations and warranties that we would have sought in an acquisition from an unrelated party; and
- we have assumed liability for debt to the Berg Group and debt for which the Berg Group was liable.

The Berg Group has agreed that the Independent Directors Committee of our Board of Directors must approve all new transactions between us and any of its members, or between us and any entity in which it directly or indirectly owns 5% or more of the equity interests, including the operating partnerships for this purpose. This committee currently consists of three directors who are independent of the Berg Group.

EXCLUDED PROPERTIES. With our prior knowledge, the Berg Group retained two R&D properties in Scotts Valley, Santa Cruz County, California, in which the operating partnerships and we have no ownership interest. Efforts of the Berg Group to lease these other properties could interfere with similar efforts on our behalf.

BERG LAND HOLDINGS. The Berg Group owns several parcels of unimproved land in the Silicon Valley that the operating partnerships and we have the right to acquire under the terms of the Berg Land Holdings Option Agreement. We have agreed to pay an amount based on pre-negotiated terms for any of the properties that we do acquire. We must pay the acquisition price in cash unless the Berg Group elects, in its discretion, to receive O.P. Units valued at the average market price of a share of common stock during the 30-trading-day period preceding the acquisition date. At the time of acquisition, which is subject to the approval of the Independent Directors Committee, these properties may be encumbered by debt that we or the operating partnerships will be required to assume or repay. The use of our cash or an increase in our indebtedness to acquire these properties could have a material adverse effect on our financial condition, results of operations and ability to make cash distributions to our stockholders. The Independent Directors Committee recently authorized the removal of a 160-acre site from the Berg Land Holdings Option Agreement if the Berg Group is able to obtain residential development zoning for any portion of this land. The Independent Directors Committee determined that this site is not likely to be of future development interest to us, and so the Berg

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

Group is now able to pursue its own residential development opportunities for this site. Any portions of such site that are rezoned as residential will no longer be subject to the Berg Land Holdings Option Agreement and will not provide any future benefit to us.

- 10 -

TAX CONSEQUENCES OF SALE OF PROPERTIES. Because many of our properties have unrealized taxable gain, a sale of those properties could create adverse income tax consequences for the limited partners of the operating partnerships. We have agreed with Carl E. Berg, Clyde J. Berg and John Kontrabecki, a limited partner in two of the operating partnerships, that prior to December 29, 2008, each of them may prevent us and the operating partnerships from selling or transferring any of the properties that were acquired from them in our July 1998 UPREIT acquisition if the proposed sale or other transfer will be a taxable transaction. As a result, our opportunities to sell these properties may be limited. If we need to sell any of these properties to raise cash to service our debt, acquire new properties, pay cash distributions to stockholders or for other working capital purposes, we may be unable to do so. These restrictions could harm our business and cause our stock price to fall.

TERMS OF TRANSFERS: ENFORCEMENT OF AGREEMENT OF LIMITED PARTNERSHIP. The terms of the Pending Projects Acquisition Agreement, the Berg Land Holdings Option Agreement, the partnership agreement of each operating partnership and other material agreements through which we have acquired our interests in the operating partnerships and the properties formerly controlled by the Berg Group were not determined through arm's-length negotiations and could be less favorable to us than those obtained from an unrelated party. In addition, Mr. Berg and representatives of the Berg Group sitting on our Board of Directors may be subject to conflicts of interests with respect to their obligations as our directors to enforce the terms of the partnership agreement of each operating partnership when such terms conflict with their personal interests. The terms of our charter and bylaws also were not determined through arm's-length negotiations. Some of these terms, including representations and warranties applicable to acquired properties, are not as favorable as those that we would have sought through arm's-length negotiations with unrelated parties. As a result, an investment in our common stock may involve risks not found in businesses in which the terms of material agreements have been negotiated at arm's length.

RELATED PARTY DEBT. As of December 31, 2004, we had borrowed approximately \$9.6 million under our \$20 million line of credit with the Berg Group, which is collateralized by five of our properties and expires in March 2006. The line of credit bears interest at an annual rate of LIBOR plus 1.30%. The Berg Group has no obligation to renew this line of credit when it expires, and we may be unable to obtain a similar credit facility on comparable terms. We are also liable under a mortgage loan of \$10.4 million due June 2010 that we assumed in connection with our acquisition of the 5300-5350 Hellyer Avenue R&D properties that we acquired in May 2000 under the Berg Land Holdings Option Agreement. If we are unable to repay our debts to the Berg Group when due, the Berg Group could take action to enforce our payment obligations. Potential actions by the Berg Group to enforce these obligations could result in the foreclosure in one or more of our properties and a reduction in the amount of cash distributions to our stockholders. In turn, if we fail to meet the minimum distributions test because of a loan default or another reason, we could lose our REIT classification for federal income tax purposes. For more information please

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

refer to Item 1, "Risk Factors - Failure to satisfy federal income tax requirements for REITs could reduce our distributions, reduce our income and cause our stock price to fall."

OUR OPTION TO ACQUIRE R&D PROPERTIES DEVELOPED ON EXISTING LAND AND LAND ACQUIRED IN THE FUTURE BY THE BERG GROUP WILL TERMINATE WHEN THE BERG GROUP'S OWNERSHIP INTEREST HAS BEEN REDUCED.

The Berg Land Holdings Option Agreement, as amended, which provides us with significant benefits and opportunities to acquire additional R&D properties from the Berg Group, will expire when the Berg Group and their affiliates (excluding us and the operating partnerships) own less than 65% of our common stock on a Fully Diluted basis. Termination of the Berg Land Holdings Option Agreement could result in limitation of our growth, which could cause our stock price to fall.

WE MAY CHANGE OUR INVESTMENT AND FINANCING POLICIES AND INCREASE YOUR RISK WITHOUT STOCKHOLDER APPROVAL.

Our Board of Directors determines the investment and financing policies of the operating partnerships and our policies with respect to certain other activities, including our business growth, debt capitalization, distribution, and operating policies. Our Board of Directors may amend these policies at any time without a vote of the stockholders. Changes in these policies could materially adversely affect our financial condition, results of operations and ability to make cash distributions to our stockholders, which could harm our business and cause our stock price to fall. For more information please refer to Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations - Policies with Respect to Certain Activities."

ANTI-TAKEOVER PROVISIONS IN OUR CHARTER COULD PREVENT ACQUISITIONS OF OUR STOCK AT A SUBSTANTIAL PREMIUM.

Provisions of our charter and our bylaws could delay, defer or prevent a transaction or a change in control of our corporation, or a similar transaction, that might involve a premium price for our shares of common stock or otherwise be in the best interests of our stockholders. Provisions of the Maryland general corporation law, which would apply to potential business combinations with acquirers other than the Berg Group or stockholders who invested in us in December 1998, also could prevent the acquisition of our stock for a premium, as discussed in "Certain Provisions of Maryland Law and of our Charter and Bylaws."

- 11 -

AN INVESTMENT IN OUR STOCK INVOLVES RISKS RELATED TO REAL ESTATE INVESTMENTS THAT COULD HARM OUR BUSINESS AND CAUSE OUR STOCK PRICE TO FALL.

RENTAL INCOME VARIES. Real property investments are subject to varying degrees of risk. Investment returns available from equity investments in real estate depend in large part on the amount of income earned and capital appreciation, which our properties generate, as well as our related expenses incurred. If our properties do not generate revenues sufficient to meet operating expenses, debt service and capital expenditures, our income and ability to make distributions to our stockholders will be adversely affected. Income from our properties may also be adversely affected by general economic conditions, local economic conditions such as oversupply of commercial real estate, the attractiveness of our properties to tenants and prospective tenants, competition from other available rental property, our ability to provide adequate maintenance and insurance, the cost of

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

tenant improvements, leasing commissions and tenant inducements and the potential of increased operating costs, including real estate taxes.

EXPENDITURES FOR PROPERTY OWNERSHIP ARE FIXED. Income from properties and real estate values are also affected by a variety of other factors, such as governmental regulations and applicable laws, including real estate, zoning and tax laws, interest rate levels and the availability of financing. Various significant expenditures associated with an investment in real estate, such as mortgage payments, real estate taxes and maintenance expenses, generally are not reduced when circumstances cause a reduction in revenue from the investment. Thus, our operating results and our cash flow may decline materially if our rental income is reduced.

ILLIQUIDITY. Real estate investments are relatively illiquid, which limits our ability to restructure our portfolio in response to changes in economic or other conditions.

GEOGRAPHIC CONCENTRATION. All of our properties are located in the southern portion of the San Francisco Bay Area commonly referred to as the "Silicon Valley." The Silicon Valley economy has been weakening for the past few years, and future increases in values and rents for our properties depend to a significant extent on the recovery of this region's economy.

LOSS OF KEY TENANTS. Single tenants, many of whom are large, publicly traded information technology companies, occupy most of our properties. We may lose tenants when existing leases expire because it may be difficult to re-lease the same property due to substantial overcapacity of R&D properties in the Silicon Valley at present. Losing a key tenant could adversely affect our operating results and our ability to make distributions to stockholders if we are unable to obtain replacement tenants promptly. Moreover, to retain key tenants upon the expiration of existing leases we may need to reduce rents, which also could adversely affect our operating results and ability to make distributions.

TENANT BANKRUPTCIES. Key tenants could seek the protection of the bankruptcy laws, which could result in the rejection and termination of their leases, thereby causing a reduction in our rental income. Under the bankruptcy laws, these tenants may have the right to reject their leases with us and our claim for rent will be limited to the greater of one year or 15% of the total amount giving under the leases upon default, but not to exceed three years of the remaining term of the lease following the earlier of the petition filing date or the date on which we gained repossession of the property, as well as any rent that was unpaid on the earlier of those dates.

OUR SUBSTANTIAL INDEBTEDNESS. Our properties are subject to substantial indebtedness. If we are unable to make required mortgage payments, we could sustain a loss as a result of foreclosure on our properties by the mortgagor. When the Berg Group line of credit expires in March 2006, we cannot assure you that we will be able to obtain a replacement line of credit with terms similar to the Berg Group line of credit, or at all. Our cost of borrowing funds could increase substantially after the Berg Group line of credit expires. Under our mortgage loan agreements with Northwestern Mutual Life Insurance Company, the payment of all \$100 million outstanding could be accelerated upon the sale or certain other transfers of more than 51% of the total number of O.P. Units and shares of common stock of the Company held by the members of the Berg Group. We have no reason to expect such a sale or transfer in the foreseeable future, but the members of the Berg Group have no obligation to us to refrain from any such sale or other transfer. We have adopted a policy of maintaining a consolidated ratio of debt to total market capitalization, which includes for this purpose the market value of all shares of common stock for which

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

outstanding O.P. Units are exchangeable, of less than 50%. This ratio may not be exceeded without the approval of more than 75% of our entire Board of Directors. Our Board of Directors may vote to change this policy, however, and we could become more highly leveraged, resulting in an increased risk of default on our obligations and an increase in debt service requirements that could adversely affect our financial condition, our operating results and our ability to make distributions to our stockholders.

ENVIRONMENTAL CLEAN-UP LIABILITIES. Our properties may expose us to liabilities under applicable environmental and health and safety laws. If these liabilities are material, our financial condition and ability to pay cash distributions may be affected adversely, which would cause our stock price to fall.

- 12 -

UNINSURED LOSSES. We may sustain uninsured losses with respect to some of our properties. If these losses are material, our financial condition, our operating results and our ability to make distributions to our stockholders may be affected adversely.

EARTHQUAKE DAMAGES ARE UNINSURED. All of our properties are located in areas that are subject to earthquake activity. Our insurance policies do not cover damage caused by seismic activity although they do cover losses from fires after an earthquake. We generally do not consider such insurance coverage to be economical. If an earthquake occurs and results in substantial damage to our properties, we could lose our investment in those properties, which loss could have a material adverse effect on our financial condition, our operating results and our ability to make distributions to our stockholders.

OUR REAL ESTATE ASSETS MAY BE SUBJECT TO IMPAIRMENT CHARGES.

We continually evaluate the recoverability of the carrying value of our real estate assets for impairment indicators. Factors considered in evaluating impairment of our existing real estate assets include significant declines in property operating profits, recurring property operating losses and other significant adverse changes in general market conditions that are considered permanent in nature. Generally, a real estate asset is not considered impaired if the undiscounted, estimated future cash flows of the asset over its estimated holding period are in excess of the asset's net book value at the balance sheet date. Assumptions used to estimate annual and residual cash flow, the estimated holding period of such assets, the lease up period when properties are vacant and future rental income require the judgment of management.

In 2004, we recorded an impairment charge to reflect the decline in value of one of our R&D properties held for sale as of the year end. For further discussion of this charge please refer to Part II, Item 8, "Consolidated Financial Statements and Supplementary Data--Note 16, Real Estate Held for Sale/Discontinued Operations." There can be no assurance that we will not take additional charges in the future related to the impairment of our assets. As of the years ended December 31, 2004 and 2003, management believes it has applied reasonable estimates and judgments in determining the proper classification of its real estate assets. However, should external or internal circumstances change requiring the need to shorten the holding periods or adjust the estimated future cash flows of certain of our assets, we could be required to record additional impairment charges. If any real estate asset held for sale is considered impaired, a loss is provided to reduce the carrying value of the asset to its fair value, less

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

selling costs. Any future impairment could have a material adverse affect on the Company's results of operations and funds from operations in the period in which the charge is taken.

FAILURE TO SATISFY FEDERAL INCOME TAX REQUIREMENTS FOR REITS COULD REDUCE OUR DISTRIBUTIONS, REDUCE OUR INCOME AND CAUSE OUR STOCK PRICE TO FALL.

FAILURE TO QUALIFY AS A REIT. Although we currently operate in a manner designed to enable us to qualify and maintain our REIT status, it is possible that economic, market, legal, tax or other considerations may cause us to fail to qualify as a REIT or may cause our Board of Directors either to refrain from making the REIT election or to revoke that election once made. To maintain REIT status, we must meet certain tests for income, assets, distributions to stockholders, ownership interests, and other significant conditions. If we fail to qualify as a REIT in any taxable year, we will not be allowed a deduction for distributions to our stockholders in computing our taxable income and would be subject to federal income tax, including any applicable alternative minimum tax, on our taxable income at regular corporate rates. Moreover, unless we were entitled to relief under certain provisions of the tax laws, we would be disqualified from treatment as a REIT for the four taxable years following the year in which our qualification was lost. As a result, funds available for distributions to our stockholders would be reduced for each of the years involved and, in addition, we would no longer be required to make distributions to our stockholders.

REIT DISTRIBUTION REQUIREMENTS. To maintain REIT status, we must distribute as a dividend to our stockholders at least 90% of our otherwise taxable income, after certain adjustments, with respect to each tax year. We also may be subject to a 4% non-deductible excise tax in the event our distributions to stockholders fail to meet certain other requirements. Failure to comply with these requirements could result in our income being subject to tax at regular corporate rates and could cause us to be liable for the excise tax.

OWNERSHIP LIMIT NECESSARY TO MAINTAIN REIT QUALIFICATION. As a REIT, the federal tax laws restrict the percentage of the total value of our stock that may be owned by five or fewer individuals to 50% or less. Our charter generally prohibits the direct or indirect ownership of more than 9% of our common stock by any stockholder. This limit excludes the Berg Group, which has an aggregate ownership limit of 20%. In addition, as permitted by our charter, our Board of Directors has authorized an exception to two other stockholders that permits them to collectively own, directly or indirectly, up to 18.5% of our common stock on an aggregate basis, subject to the terms of an ownership limit exemption agreement. In general, our charter prohibits the transfer of shares that result in a loss of our REIT qualification and provides that any such transfer or any other transfer that causes a stockholder to exceed the ownership limit will result in the shares being automatically transferred to a trust for the benefit of a charitable beneficiary. Accordingly, in the event that either the Berg Group or the two stockholders increase their stock ownership in our corporation, a stockholder who acquires shares of our common stock, even

- 13 -

though his, her or its aggregate ownership may be less than 9%, may be required to transfer a portion of that stockholder's shares to such a trust in order to preserve our status as a REIT.

STOCKHOLDERS ARE NOT ASSURED OF RECEIVING CASH DISTRIBUTIONS FROM US.

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

Our income consists primarily of our share of the income of the operating partnerships, and our cash flow consists primarily of our share of distributions from the operating partnerships. Differences in timing between the receipt of income and the payment of expenses in arriving at our taxable income or the taxable income of the operating partnerships and the effect of required debt amortization payments could require us to borrow funds, directly or through the operating partnerships, on a short-term basis to meet our intended distribution policy.

Our Board of Directors will determine the amount and timing of distributions by the operating partnerships and of distributions to our stockholders. Our Board of Directors will consider many factors prior to making any distributions, including the following:

- the amount of cash available for distribution;
- the operating partnerships' financial condition;
- whether to reinvest funds rather than to distribute such funds;
- the operating partnerships' capital expenditures;
- the effects of new property acquisitions, including acquisitions under our existing agreements with the Berg Group;
- the annual distribution requirements under the REIT provisions of the federal income tax laws;
- our projected rental rates and revenues; and
- such other factors as our Board of Directors deems relevant.

We cannot assure you that we will be able to meet or maintain our cash distribution objectives.

OUR PROPERTIES COULD BE SUBJECT TO PROPERTY TAX REASSESSMENTS.

We do not believe that the acquisition of any of our interests in the operating partnerships has resulted in a statutory change in ownership that could give rise to a reassessment of any of our properties for California property tax purposes. We cannot assure you, however, that county assessors or other tax administrative agencies in California will not attempt to assert that such a change occurred as a result of these transactions. Although we believe that such a challenge would not be successful ultimately, we cannot assure you regarding the outcome of any related dispute or proceeding. A reassessment could result in increased real estate taxes on our properties that, as a practical matter, we may be unable to pass through to our tenants in full. This could reduce our net income and our funds available for distributions and cause our stock price to fall.

OUR OBLIGATION TO PURCHASE TENDERED O.P. UNITS COULD REDUCE OUR CASH DISTRIBUTIONS.

Each of the limited partners of the operating partnerships, other than Carl E. Berg and Clyde J. Berg, has the annual right to cause the operating partnerships to purchase the limited partner's O.P. Units at a purchase price based on the average market value of the common stock for the ten-trading-day period immediately preceding the date of tender. Upon a limited partner's exercise of any such right, we will have the option to purchase the tendered O.P. Units with available cash, borrowed funds or the proceeds of an offering of newly issued shares of common stock. These put rights became exercisable on December 29, 1999, and are available once

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

during a 12-month period. If the total purchase price of the O.P. Units tendered by all of the eligible limited partners in one year exceeds \$1 million, the operating partnerships or we will be entitled to reduce proportionately the number of O.P. Units to be acquired from each tendering limited partner so that the total purchase price does not exceed \$1 million. The exercise of these put rights may reduce the amount of cash that we have available to distribute to our stockholders and could cause our stock price to fall.

In addition, all O.P. Unit holders may tender their O.P. Units to us in exchange for shares of common stock on a one-for-one basis at then-current market value or an equivalent amount in cash, at our election. If we elect to pay cash for the O.P. Units, our liquidity may be reduced and we may lack sufficient funds to continue paying the amount of our anticipated or historical cash distributions. This could cause our stock price to fall.

- 14 -

SHARES ELIGIBLE FOR FUTURE SALE COULD AFFECT THE MARKET PRICE OF OUR STOCK.

We cannot predict the effect, if any, that future sales of shares of common stock, or the availability of shares for future sale, could have on the market price of our common stock. As of December 31, 2004, all outstanding shares of our common stock, other than shares controlled by affiliates, were eligible for sale in the public market without resale restrictions under the federal securities laws. Sales of substantial amounts of common stock, including shares issued in connection with the exercise of the exchange rights held by the limited partners of the operating partnerships, or the perception that such sales could occur, could adversely affect prevailing market prices for the common stock. Additional shares of common stock may be issued to limited partners, subject to the applicable REIT qualification ownership limit, if they exchange their O.P. Units for shares of common stock pursuant to their exchange rights, or may be sold by us to raise funds required to purchase such O.P. Units if eligible limited partners elect to tender O.P. Units to us using their put rights. Shares of stock controlled by our affiliates may be sold subject to Rule 144, including the limitation under Rule 144(e) on the number of shares that may be sold within a three-month period. Additional common stock reserved under our 2004 Incentive Plan, including stock options, may also be sold in the market at some time in the future. Future sales of our common stock in the market could adversely affect the price of our common stock.

MARKET INTEREST RATES MAY REDUCE THE VALUE OF THE COMMON STOCK.

One of the factors that investors consider important in deciding whether to buy or sell shares of a REIT is the distribution rate on such shares, as a percentage of the price of such shares, relative to market interest rates. If market interest rates go up, prospective purchasers of REIT shares may expect a higher distribution rate. Higher interest rates would not, however, increase the funds available for us to distribute, and, in fact, would likely increase our borrowing costs and decrease funds available for distributions. Thus, higher market interest rates could cause the price of our common stock to fall.

- 15 -

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

GEOGRAPHIC AND TENANT FOCUS

We focus principally on the facility requirements of information technology companies in the Silicon Valley, which include space for office, R&D, light manufacturing and assembly. With the Silicon Valley's highly educated and skilled work force, history of numerous successful start-up companies and large contingent of venture capital firms, we believe that this region will, following the current significant slowdown in the market, continue to spawn successful new high-growth industries and entrepreneurial businesses to an extent matched nowhere else in the United States. We believe that our focus and thorough understanding of the Silicon Valley real estate market enables us to:

- anticipate trends in the market;
- identify and concentrate our efforts on the most favorably located sub-markets;
- take advantage of our experience and extensive contacts and relationships with local government agencies, real estate brokers and subcontractors, as well as with tenants and prospective tenants; and
- identify strong tenants.

All of our properties are general-purpose R&D/office type properties located in desirable sub-markets of the Silicon Valley. Many of our properties have been developed for or leased to single tenants, many of whom are large, publicly traded information technology companies. Most of our major tenants have occupied our properties for many years under triple-net leases that require the tenant to pay substantially all operating costs, including property insurance, real estate taxes and general operating costs.

LEASING

The current leases for the properties have terms ranging from one to eleven years. Most of the leases provide for fixed periodic rental increases. Substantially all of the leases are triple-net leases pursuant to which the tenant is required to pay substantially all of the operating expenses of the property, property taxes and insurance, including all maintenance and repairs, and excluding only certain structural repairs to the building shell. Most of the leases contain renewal options that allow the tenant to extend the lease based on adjustments to then prevailing market rates, or based on fixed rental adjustments, which may be at or below market rates.

PROPERTY PORTFOLIO

All of our properties are R&D/office type properties. Generally, these properties are one- to two-story buildings of tilt-up concrete construction, have on average 3.5 or more parking spaces per thousand rentable square feet, clear ceiling heights of less than 18 feet, and range in size from approximately 4,500 to 239,000 rentable square feet. Most of the office space is open and suitable for configuration to meet the tenants' requirements with the use of movable dividers.

The following table sets forth certain information relating to our properties as of December 31, 2004:

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

Location	No. of Properties	Total Rentable Sq. Ft.	Percentage Leased as of Dec. 31, 2004	Average 2004 Occupancy	Major Tenants
5300-5350 Hellyer Avenue (2)	2	160,000	100%	100%	Tyco Electronics
10401-10411 Bubb Road (2)	1	20,330	100%	100%	Celerity Systems
45365 Northport Loop West	1	64,218	31%	31%	Applied Micro Ci
45700 Northport Loop East	1	47,570	100%	100%	Philips Electron
45738 Northport Loop West	1	44,256	100%	100%	EIC Corporation
4050 Starboard Drive	1	52,232	100%	100%	Flash Electronic
3501 W. Warren Avenue & 46600 Fremont Blvd.	1	67,864	52%	18%	ASM Nutool, Inc.

- 16 -

Location	No. of Properties	Total Rentable Sq. Ft.	Percentage Leased as of Dec. 31, 2004	Average 2004 Occupancy	Major Tenants
48800 Milmont Drive	1	53,000	0%	0%	Vacant
4750 Patrick Henry Drive	1	65,780	53%	31%	CHIPS ag, Inc.
Triangle Technology Park (2)	7	416,927	62%	63%	Intevac Corporat JDS Uniphase Cor Xicom Technology IXYS Technologie
5850-5870 Hellyer Avenue	1	109,715	7%	7%	Silver Creek Val
5750 Hellyer Avenue	1	73,312	0%	0%	Vacant
800 Embedded Way	1	239,000	0%	0%	Vacant
5500-5550 Hellyer Avenue	2	196,534	23%	23%	ACT Electronics,
5400 Hellyer Avenue	1	77,184	71%	30%	Tasman Networks, StorCard, Inc.
5325-5345 Hellyer Ave.	2	256,500	100%	100%	Celestica Asia,
5905-5965 Silver Creek	4	346,000	100%	100%	CIENA Corporatio
855 Embedded Way	1	67,912	100%	100%	Linuxworks, Inc.
1065 La Avenida Street	5	515,700	100%	100%	Microsoft Corpor
1750 Automation Parkway	1	80,641	100%	100%	JDS Uniphase Cor

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

1756 Automation Parkway	1	80,640	100%	100%	JDS Uniphase Cor
1762 Automation Parkway	1	61,100	100%	100%	JDS Uniphase Cor
1768 Automation Parkway	1	110,592	100%	100%	JDS Uniphase Cor
255 Caspian Drive	1	98,500	0%	0%	Vacant
245 Caspian Drive (3)	1	-	0%	0%	Vacant
5970 Optical Court	1	128,520	100%	100%	Photon Dynamics,
5900 Optical Court	1	165,000	100%	100%	Stryker Endoscop
2630 Orchard Parkway	1	60,633	64%	5%	Maranti, Inc.
2610 Orchard Parkway	1	54,093	0%	25%	Vacant
55 West Trimble Road	1	91,722	0%	25%	Vacant
2001 Walsh Avenue	1	80,000	100%	100%	NEC Electronics Inc.
2880 Scott Boulevard	1	200,000	100%	100%	NEC Electronics Inc.
2890 Scott Boulevard	1	75,000	100%	100%	NEC Electronics Inc.
2800 Scott Boulevard	1	98,430	75%	75%	Nvidia Corporati
2300 Central Expressway	1	46,338	100%	100%	JDS Uniphase Cor
2220 Central Expressway	1	62,522	100%	100%	BRE/San Tomas LL
2330 Central Expressway	1	62,522	0%	0%	Vacant
2251 Lawson Lane	1	125,000	100%	100%	Fujitsu IT Holdi
1230 East Arques	1	60,000	100%	100%	Fujitsu IT Holdi
1250 East Arques	4	200,000	100%	100%	Fujitsu IT Holdi

- 17 -

Location	No. of Properties	Total Rentable Sq. Ft.	Percentage Leased as of Dec. 31, 2004	Average 2004 Occupancy	Major Tenants
3120 Scott Blvd. (4)	1	75,000	16%	40%	DSP Group, Inc.
20400 Mariani Avenue	1	105,000	100%	100%	Dade Behring, In
10500 De Anza Blvd.	1	211,000	100%	100%	Apple Computer,
20605-705 Valley Green Dr.	2	142,000	100%	100%	Apple Computer,
10300 Bubb Road	1	23,400	100%	100%	Apple Computer,
10440 Bubb Road	1	19,500	100%	83%	Lightmaster Syst

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

10460 Bubb Road	1	45,460	67%	67%	Luminous Network
1135 Kern Avenue	1	18,300	50%	50%	Broadmedia, Inc.
1190 Morse Avenue & 405 Tasman Avenue	1	28,350	0%	55%	Vacant
450 National Avenue	1	36,100	100%	100%	ePeople, Inc.
3301 Olcott Street	1	64,500	0%	0%	Vacant
2800 Bayview Avenue	1	59,736	0%	35%	Vacant
6850 Santa Teresa Blvd.	1	30,000	59%	59%	Indala Corporati
6810 Santa Teresa Blvd.	1	54,996	100%	100%	Polaris Networks
140-160 Great Oaks Blvd. & 6781 Via Del Oro	2	105,300	75%	75%	Amtech Microelec Saint Gobain Santa Clara Wate
6540-6541 Via Del Oro & 6385-6387 San Ignacio Ave.	2	66,600	74%	74%	Exsil, Inc. Modutek Corporat
6311-6351 San Ignacio Ave.	5	362,767	44%	63%	Saint Gobain Avnet, Inc. Teledex, LLC
6320-6360 San Ignacio Ave.	1	157,292	71%	71%	Nortel Networks Quantum 3D, Inc.
75 East Trimble Road & 2610 North First Street	2	170,810	100%	100%	Comerica Bank County of Santa
2033-2243 Samaritan Drive	3	235,122	36%	36%	Texas Instrument State Farm Insur Good Samaritan H
1170 Morse Avenue	1	39,231	100%	100%	The Parkinson's
3236 Scott Blvd.	1	54,672	100%	100%	Celeritek, Inc.
1212 Bordeaux Lane	1	71,800	100%	100%	Northrop Grumman
McCandless Technology Park	14	705,956	48%	54%	Arrow Electronic Chartered Semico ST Assembly Test Services, Inc. Hermes Microvisi ASM Internationa A&D Engineering,
1600 Memorex Drive	1	107,500	100%	100%	Sasco Electric International Ne Services
1688 Richard Avenue	1	52,800	100%	100%	NWE Technology,

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

Location	No. of Properties	Total Rentable Sq. Ft.	Percentage Leased as of Dec. 31, 2004	Average 2004 Occupancy	Major Tenants
1700 Richard Avenue	1	58,783	100%	100%	Broadwing Comm S Inc.
TOTAL	109	7,917,262			

- (1) Annual cash rents do not include any effect for recognition of rental income on the straight-line method of accounting required by generally accepted accounting principles in the United States of America under which contractual rent payment increases are recognized evenly over the lease term.
- (2) Joint venture properties.
- (3) Property represents a commitment by the Berg Group to construct an approximate 75,000 to 90,000 square foot building on land acquired during 2001.
- (4) The property at 3120 Scott Boulevard was designated as asset held for sale at December 31, 2004 and was sold in January 2005.

We own 100% of all of the properties, except for one of the buildings in the Triangle Technology Park, which is owned by a joint venture in which we, through an operating partnership, own a 75% interest, the property at 10401-10411 Bubb Road, which is owned by a joint venture in which we, through an operating partnership, own an 83.33% interest, and the properties at 5300-5350 Hellyer Avenue, which are owned by a joint venture in which we, through an operating partnership, own a 50% interest, and a Berg affiliate owns the other 50% venture interest.

- 19 -

LEASE EXPIRATIONS

The following table sets forth a schedule of the lease expirations for the properties beginning with 2005, assuming that none of the tenants exercise existing renewal options or termination rights. The table excludes 2,358,928 rentable square feet that was vacant as of January 1, 2005.

Year of Lease Expiration	Number of Leases Expiring	Rentable Square Footage Subject to Expiring Leases	2005 Annual Base Rent Under Expiring Leases (1)
2005	21	501,460	\$ 4,760,370
2006	15	551,608	15,437,030
2007	19	1,126,081	21,327,717
2008	7	300,023	3,584,473

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

2009	14	711,305	11,807,241
2010	6	452,186	8,123,520
2011	3	696,484	14,533,982
2012	3	335,187	7,310,028
2014	3	649,000	11,692,924
Thereafter	1	160,000	3,518,068

	92	5,483,334	\$102,095,353
=====			

- (1) The base rent for leases expiring is based on scheduled 2005 cash rents, which are different than annual rents determined in accordance with GAAP.
(2) Based upon 2005 cash rents as discussed in Note (1).

If we are unable to lease a significant portion of the available space or space scheduled to expire in 2005 and thereafter at any of our properties; if existing tenants do not renew their leases; or if rental rates decrease, our results of operations, financial condition and cash flows would be adversely affected.

ENVIRONMENTAL MATTERS

To date, compliance with laws and regulations relating to the protection of the environment, including those regarding the discharge of materials into the environment has not had any material effects upon our capital expenditures, earnings or competitive position.

Under various federal, state and local laws, ordinances and regulations, an owner or operator of real property may be held liable for the costs of removal or remediation of certain hazardous or toxic substances located on or in the property. Such laws often impose liability on the owner and expose the owner to governmental proceedings without regard to whether the owner knew of, or was responsible for, the presence of the hazardous or toxic substances. The cost of any required remediation or removal of such substances may be substantial. In addition, the owner's liability as to any specific property is generally not limited and could exceed the value of the property and/or the aggregate assets of the owner. The presence of such substances, or the failure to properly remove or remediate such substances, may also adversely affect the owner's ability to sell or rent the property or to borrow using the property as collateral. Persons who arrange for treatment or the disposal of hazardous or toxic substances may also be liable for the costs of any required remediation or removal of the hazardous or toxic substances at a disposal facility, regardless of whether the facility is owned or operated by such owner or entity. In connection with the ownership of the properties or the treatment or disposal of hazardous or toxic substances, we may be liable for such costs.

Some of our properties are leased, in part, to businesses, including manufacturers that use, store or otherwise handle hazardous or toxic substances in their business operations. These operations create a potential for the release of hazardous or toxic substances. In addition, groundwater contaminated by chemicals used in various manufacturing processes, including semiconductor fabrication, underlies a significant portion of northeastern Santa Clara County, where many of our properties are located.

Environmental laws also govern the presence, maintenance and removal of asbestos. These laws require that owners or operators of buildings containing asbestos properly manage and maintain the asbestos, that they adequately inform or train those who may come into contact with asbestos and that they undertake special precautions, including removal or other abatement in the event that asbestos is disturbed during renovation or demolition of a building. These laws may impose fines and penalties on building owners or operators for failure to comply with these requirements and may allow third parties to seek recovery from owners or operators for personal injury associated with exposure to asbestos fibers. We are aware that there are asbestos-containing materials, or ACMs, present at several of the properties, primarily in floor coverings. We believe that the ACMs present at these properties are generally in good condition and that no ACMs are present at the remaining properties. We believe we are in compliance in all material respects with all present federal, state and local laws relating to ACMs and that if we were given limited time to remove all ACMs present at the properties, the cost of such removal would not have a material adverse effect on our financial condition, results of operations and ability to make cash distributions to our stockholders.

Phase I assessments are intended to discover and evaluate information regarding the environmental condition of the surveyed property and surrounding properties. Phase I assessments generally include a historical review, a public records review, an investigation of the surveyed site and surrounding properties and the preparation and issuance of a written report, but do not include soil sampling or subsurface investigations and typically do not include an asbestos survey. Environmental assessments have been conducted for about half of the properties.

The environmental investigations that have been conducted on our properties have not revealed any environmental liability that we believe would have a material adverse effect on our financial condition, results of operations and assets, and we are not aware of any such liability. Nonetheless, it is possible that there are material environmental liabilities of which we are unaware. We cannot assure you that future laws, ordinances, or regulations will not impose any material environmental liability, or that the current environmental condition of the properties has not been, or will not be, affected by tenants and occupants of the properties, by the condition of properties in the vicinity of the properties, or by third parties unrelated to us.

ITEM 3. LEGAL PROCEEDINGS

Neither the operating partnerships, the properties nor we are subject to any material litigation nor, to our knowledge, is any material litigation threatened against the operating partnerships, the properties or us. From time to time, we are engaged in legal proceedings arising in the ordinary course of our business. We do not expect any of such proceedings to have a material adverse effect on our cash flows, financial condition or results of operations. We are currently involved in or have recently concluded the following legal proceedings which we believe the ultimate outcome, will have no material adverse effect on our financial statements.

REPUBLIC PROPERTIES CORPORATION ("RPC") V. MISSION WEST PROPERTIES, L.P. ("MWP"), IN THE CIRCUIT COURT OF MARYLAND FOR BALTIMORE CITY CASE NO. 24-C-00-005675. RPC is a former 50% partner with Mission West Properties, L.P. in the Hellyer Avenue Limited Partnership ("Hellyer LP"). In April

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

2004 the Circuit Court for Baltimore City, Maryland issued a Memorandum Opinion in the case and awarded damages of \$933,548 to the RPC plaintiffs, which must be paid by us or MWP. The court denied all requests by MWP, including a declaration that all of RPC's interests in Heller L.P. were validly converted to limited partnership interests and transferred to MWP or its designee in accordance with the terms of the Hellyer L.P. partnership agreement. The court also denied RPC's request for an injunction ordering the reinstatement of RPC's partnership interests in Hellyer L.P. We have appealed the decision to the Maryland Appeals Court. We do not believe that any further court decisions in this case, for or against us and MWP, will have a material adverse effect on our business. We have a receivable from a Berg Group affiliate for the amount of distributions it received as the successor to RPC's interest in the Hellyer LP which exceeds the amount of the damages awarded to the RPC parties and would be used to pay for those damages in the event the decision of the Circuit Court is upheld ultimately. Furthermore, we have never accounted for the 50% interest of RPC as our asset and if RPC is deemed to have retained that interest or reacquires that interest our balance sheet and financial condition would not be impacted. Although to date, we have consolidated the assets, liabilities and operating results of the Hellyer LP and allocated 50% of the operating income to the minority interest holder. In February 2001, we filed a suit against RPC in Superior Court of the State of California for the County of Santa Clara Case No. CV 796249 which has been stayed pending resolution of the Maryland case. In July 2004, RPC attached our bank account for approximately \$1.1 million. Following a July 2004 hearing in Superior Court of the State of California for the County of Santa Clara, the parties agreed that we will post a \$1.5 million bond and RPC will remove the attachment of our bank account until final resolution of the appeal in Maryland. On February 4, 2005, the Maryland Appeals Court heard our appeal. On March 1, 2005, the Maryland Appeals Court ruled in favor of MWP, finding that the Circuit Court of Maryland could not assert personal jurisdiction in the RPC suit. The Maryland Appeals Court will issue its mandate within 30 days, after which RPC will have 15 days to seek a writ of certiorari to the Maryland Appeals Court.

In January 2004, we filed the case of MISSION WEST PROPERTIES, L.P. V. PREMISYS COMMUNICATIONS, INC. AND ZHONG TECHNOLOGIES, INC. IN THE SUPERIOR COURT OF THE STATE OF CALIFORNIA FOR THE COUNTY OF ALAMEDA CASE NO. HG03118906 for breach of lease agreement and claimed damages of \$1,399,042. In April 2004, we settled the matter and received a payment of \$1,100,000. This amount was recorded in other income during the second quarter of 2004.

In December 2003, CRAIG R. JALBERT LIQUIDATING CEO, AS REPRESENTATIVE OF THE ESTATE OF THE CONSOLIDATED DEBTORS FOR ACT MANUFACTURING, INC V. MISSION WEST PROPERTIES, L.P. filed an action in United States Bankruptcy Court District of Massachusetts Case No. 01-47641 (JBR) asserting that payments of \$481,749 made in the ordinary course of business within 90 days of the ACT bankruptcy filing were preference payments. In December 2004, we settled this matter and received a final payment of \$276,166, which we recorded as other income in our consolidated statements of operations.

In January 2004, the GLOBAL CROSSING ESTATE REPRESENTATIVE, FOR ITSELF AND THE LIQUIDATING TRUSTEE OF THE GLOBAL CROSSING LIQUIDATING TRUST V. MISSION WEST PROPERTIES L.P. filed an action in United States Bankruptcy Court Southern District of New York Case No. 02-40188 (REG) asserting that payments of \$815,052 made in the ordinary course of business within 90 days of the Global Crossing bankruptcy filing were preference payments. In addition, the Global debtors and the Creditors' Committee filed an objection to the unsecured claim filed by Mission West Properties in the Global cases for \$16,710,605. A hearing on the claim objection is set for March 23, 2005. A trial date has not been set for either the unsecured

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

claim objection or preference litigation.

- 22 -

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

- a) The annual meeting of stockholders of the Company was held on November 24, 2004 in which proxies representing 16,066,957 shares of common stocks, or 88.9% of the total outstanding shares, voted.
- b) At the annual meeting of stockholders, Carl E. Berg, John C. Bolger, William A. Hasler, Lawrence B. Helzel, and Raymond V. Marino were elected as directors for the ensuing year, all of whom were serving on the board of directors at the time of the meeting.
- c) The following proposals were voted upon at the meeting:

Proposal No. 1: Election of Directors

Directors	Total Vote for Each Director	Total Vote Withheld from Each Director
Carl E. Berg	15,784,039	82,226
John C. Bolger	15,766,691	99,574
William A. Hasler	15,764,941	101,324
Lawrence B. Helzel	15,767,411	98,854
Raymond V. Marino	15,614,292	251,973

Proposal No. 2: Approval of (i) the adoption of the Company's 2004 Equity Incentive Plan, (ii) the transfer to the 2004 Equity Incentive Plan of up to 3,991,089 remaining shares available for grant under the 1997 Stock Option Plan; (iii) the transfer of up to 767,000 shares subject to outstanding options under the 1997 Stock Option Plan if they expire unexercised; and (iv) the material terms of the 2004 Equity Incentive Plan and the performance goals thereunder for purposes of Internal Revenue Code Section 162(m). There were 6,590,691 votes in favor of the proposal, 3,358,560 votes against the proposal and 212,925 abstentions.

Proposal No. 3: Ratification of the selection of the accounting firm of BDO Seidman, LLP as the Company's independent registered public accounting firm for the year ended December 31, 2004. There were 15,979,270 votes in favor of the proposal, 29,244 votes against the proposal and 58,442 abstentions.

- 23 -

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

Our common stock is listed on the American Stock Exchange ("AMEX") and the Pacific Exchange, Inc. and trades under the symbol "MSW." The high and low closing sale prices per share of common stock as reported on AMEX during each quarter of 2004 and 2003 were as follows:

	2004		2003	
	High	Low	High	Low
1st Quarter	\$14.00	\$12.81	\$10.25	\$ 9.51
2nd Quarter	\$13.44	\$11.40	\$11.95	\$ 9.51
3rd Quarter	\$12.14	\$ 9.95	\$12.74	\$11.40
4th Quarter	\$10.95	\$ 9.51	\$13.45	\$12.74

On February 28, 2005, there were 196 registered holders of the Company's common stock. We declared and paid dividends in each quarter of 2004 and 2003. We expect to pay quarterly dividends during 2005. The following tables show information for quarterly dividends for 2004 and 2003.

	2004		
	Record Date	Payment Date	Dividend Per Share
1st Quarter	03/31/04	04/08/04	\$0.24
2nd Quarter	06/30/04	07/08/04	0.24
3rd Quarter	09/30/04	10/07/04	0.24
4th Quarter	12/31/04	01/07/05	0.16
Total			\$0.88

	2003		
	Record Date	Payment Date	Dividend Per Share
1st Quarter	03/31/03	04/10/03	\$0.24
2nd Quarter	06/30/03	07/10/03	0.24
3rd Quarter	09/30/03	10/09/03	0.24
4th Quarter	12/31/03	01/08/04	0.24
Total			\$0.96

For federal income tax purposes, we have characterized 98% of the dividends declared in 2004 and 2003 as taxable ordinary income and 2% as return of capital.

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

The closing price of our common stock on December 31, 2004, the last trading day, was \$10.64 per share.

- 24 -

ITEM 6. SELECTED FINANCIAL DATA

The following table sets forth selected historical financial information for Mission West Properties, Inc. See Part II - Item 7, "Management's Discussion and Analysis of Financial Conditions and Results of Operations" - Overview and Company History for discussion of business combinations and property dispositions that materially affect the comparability of the selected financial data.

Selected consolidated financial data is derived from the audited financial statements and notes thereto (see Part II - Item 8, "Consolidated Financial Statements and Supplementary Data," below) and is as follows:

	Year Ended Dec		
	2004	2003	2002
	(dollars in thousands, ex		
OPERATING DATA:			
Revenue:			
Rental revenue from real estate	\$119,523	\$129,511	\$128,55
Tenant reimbursements	14,946	18,726	19,95
Other income	6,914	4,527	4,24
Total revenues	141,383	152,764	152,75
Expenses:			
Property operating, maint. and real estate taxes	20,540	21,220	23,80
Interest	17,581	16,446	9,58
Interest (related parties)	1,077	1,064	3,42
General and administrative	2,011	1,324	1,48
Depreciation and amortization of real estate	21,669	20,525	18,06
Total expenses	62,878	60,579	56,37
Income before gain on sales of assets, equity in earnings of unconsolidated joint venture and minority interests	78,505	92,185	96,38
Gain on sales of assets	-	-	
Equity in earnings of unconsolidated joint venture	2,947	3,885	
Minority interests	67,699	80,069	80,54
Income from continuing operations	13,753	16,001	15,83
Discontinued operations, net of minority interests:			
Gain from disposal of discontinued operations	-	-	1,01
(Loss)/income attributable to discontinued operations (4)	(441)	211	25

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

(Loss)/income from discontinued operations	(441)	211	1,27
Net income to common stockholders	\$13,312	\$16,212	\$17,11
Net income to minority interests	\$66,100	\$80,836	\$86,64
Basic net income from continuing operations per share	\$0.76	\$0.90	\$0.9
Diluted net income from continuing operations per share	\$0.76	\$0.90	\$0.8
Basic net (loss)/income from discontinued operations per share	(\$0.02)	\$0.01	\$0.0
Diluted net (loss)/income from discontinued operations per share	(\$0.02)	\$0.01	\$0.0
Basic net income per share	\$0.74	\$0.91	\$0.9
Diluted net income per share	\$0.74	\$0.91	\$0.9
Dividends per share	\$0.88	\$0.96	\$0.9
PROPERTY AND OTHER DATA:			
Total properties, end of period (3)	109	109	10
Total square feet, end of period (000's)	7,917	7,917	7,16
Average monthly rental revenue per square foot (1)	\$1.80	\$1.77	\$1.7
Occupancy at end of period	71%	77%	8
FUNDS FROM OPERATIONS (2):	\$103,320	\$117,918	\$118,44
Cash flows from operating activities	\$105,070	\$116,493	\$117,36
Cash flows used in investing activities	(1,519)	(109,983)	(20,74
Cash flows used in financing activities	(106,161)	(6,860)	(97,45

- 25 -

	December		
	2004	2003	2002
(dollars in t			
BALANCE SHEET DATA:			
Real estate assets,			
net of accumulated depr. & amort.	\$ 960,863	\$ 985,751	\$886,1
Total assets	1,005,656	1,032,632	926,7
Line of credit - related parties	9,560	6,320	58,7
Revolving line of credit	24,208	23,965	23,8
Loan payable	-	-	20,0
Debt	292,822	299,858	125,0
Debt - related parties	10,420	10,762	11,0
Total liabilities	380,355	394,324	289,8
Minority interests	512,089	524,918	526,5
Stockholders' equity	113,212	113,390	110,3
Common stock outstanding	18,097,191	17,894,691	17,487,3
O.P. Units issued and outstanding	86,384,695	86,398,064	86,474,0

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

- (1) Average monthly rental revenue per square foot has been determined by taking the total cash base rent for the period divided by the number of months in the period, and then divided by the average occupied square feet in the period.
- (2) Funds From Operations ("FFO") is a non-GAAP financial instrument used by REITs to measure and compare operating performance. As defined by the National Association of Real Estate Investment Trusts ("NAREIT"), FFO represents net income (loss) before minority interest of unit holders (computed in accordance with GAAP), including non-recurring events other than "extraordinary items" under GAAP and gains and losses from debt restructuring and sales of discontinued operations, plus real estate related depreciation and amortization (excluding amortization of deferred financing costs and depreciation of non-real estate assets) and after adjustments for unconsolidated partnerships and joint ventures. We have revised our FFO computations for 2002 and 2001 for the inclusion of the amortization of leasing commissions in depreciation and amortization of real estate in order to be comparable to our 2004 and 2003 FFO presentation and to more closely conform to the NAREIT's FFO definition. Additionally, our 2004 and 2003 FFO calculation includes our portion of the depreciation and amortization of real estate from our unconsolidated joint venture, but excludes the above-market lease intangible asset, which was recorded as a reduction of revenues. Management considers FFO an appropriate measure of performance of an equity REIT because, along with cash flows from operating activities, financing activities and investing activities, it provides investors with an understanding of our ability to incur and service debt and make capital expenditures. FFO should not be considered as an alternative for neither net income as a measure of profitability nor is it comparable to cash flows provided by operating activities determined in accordance with GAAP. FFO is not comparable to similarly entitled items reported by other REITs that do not define them exactly as we define FFO. SEE PART II - ITEM 7, "MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - FUNDS FROM OPERATIONS" FOR RECONCILIATION OF OUR FFO FIGURES TO OUR NET INCOME DETERMINED IN ACCORDANCE WITH GAAP.
- (3) As of December 31, 2004, 2003, 2002 and 2001, total properties include a property at 245 Caspian in Sunnyvale with no building. During 2001, the Company paid the Berg Group approximately \$7.5 million for their commitment to complete an approximate 75,000 to 90,000 square foot building on the property.
- (4) Upon the implementation of SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," on January 1, 2002, the operating results of real estate held for sale and sold are reported as discontinued operations for all years presented. Additionally, all gains and losses on the sale of assets classified as held for sale subsequent to January 1, 2002 are included in discontinued operations. As the operating results and gains or losses from the sale of real estate assets prior to January 1, 2002 are included in continuing operations, the presentation of results is not comparable between years.

- 26 -

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

THE FOLLOWING DISCUSSION INCLUDES FORWARD-LOOKING STATEMENTS, INCLUDING BUT NOT LIMITED TO STATEMENTS WITH RESPECT TO THE FUTURE FINANCIAL PERFORMANCE, OPERATING RESULTS, PLANS AND OBJECTIVES OF MISSION WEST PROPERTIES, INC. ACTUAL RESULTS MAY DIFFER MATERIALLY FROM THOSE CURRENTLY ANTICIPATED DEPENDING UPON A VARIETY OF FACTORS, INCLUDING THOSE DESCRIBED IN PART I -

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

ITEM 1, "BUSINESS - RISK FACTORS."

OVERVIEW AND BACKGROUND

Our original predecessor was formed in 1969 as Palomar Mortgage Investors, a California business trust, which operated as a mortgage REIT until 1979 when, under the name of Mission Investment Trust, it terminated its status as a REIT and began to develop and market its own properties. In 1982, Mission West Properties was incorporated as a successor to Mission Investment Trust. In 1997, our predecessor, Mission West Properties, sold all its real estate assets and paid a special dividend of \$9.00 per share to stockholders, after which it retained only nominal assets. Subsequently, the Berg Group acquired control of the corporation as a vehicle to acquire R&D properties, or interests in entities owning such properties in a transaction completed September 2, 1997. At that time the Berg Group and the other investors acquired an aggregate 79.6% controlling ownership position. In May 1998, we, the Berg Group members, an independent limited partner, and certain other persons entered into an acquisition agreement providing, among other things, for our acquisition of interests as the sole general partner in the operating partnerships. At the time, the operating partnerships held approximately 4.34 million rentable square feet of R&D property located in Silicon Valley. The agreement also provided for the parties to enter into the Pending Projects Acquisition Agreement, the Berg Land Holdings Option Agreement and the Exchange Rights Agreement, following stockholder approval. Effective July 1, 1998, we consummated our acquisition of the general partnership interests in the operating partnerships through the purchase of the general partnership interests, and all limited partnership interests in the operating partnerships were converted into 59,479,633 O.P. Units, which represented ownership of approximately 87.89% of the operating partnerships. Our general partnership interests represented the balance of the ownership of the operating partnerships. At December 31, 2004, we owned a 17.26% general partnership interest in the operating partnerships, taken as a whole, on a weighted average basis.

Since the beginning of calendar year 1999, we have been taxed as a qualified REIT.

Our reincorporation under the laws of the State of Maryland through the merger of Mission West Properties into Mission West Properties, Inc. occurred on December 30, 1998, at which time all outstanding shares issued by our predecessor California corporation were converted into shares of our common stock on a one-for-one basis.

In July 1999, we completed a public offering of 8,680,000 shares of our common stock at \$8.25 per share. The net proceeds of approximately \$66.9 million, after deducting underwriting discounts and other offering costs, were used primarily to repay indebtedness.

We have grown through property acquisitions. Since September 1998, we have acquired a total of approximately 4 million rentable square feet of R&D buildings under the Pending Project Acquisition Agreement, the Berg Land Holdings Option Agreement, and from unrelated third parties. The total cost of these properties was approximately \$619 million. We issued a total of 27,962,025 O.P. Units and assumed debt totaling approximately \$308 million to acquire them. Major property acquisitions made by us from unrelated sellers include the following:

On March 8, 2002, we acquired the Orchard-Trimble property consisting of three R&D Properties with a total of approximately 206,500 rentable square feet for \$31.3 million in cash. The acquisition of those properties was part of a tax-deferred exchange under section 1031 of the Internal Revenue

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

Code.

On April 9, 2003, we acquired the 36-acre San Tomas Technology Park consisting of seven R&D properties with a total of approximately 625,000 rentable square feet for \$110 million. We financed that acquisition through new debt and an existing line of credit.

- 27 -

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

We prepare our consolidated financial statements in conformity with accounting principles generally accepted in the United States of America ("GAAP"), which requires us to make certain estimates, judgments and assumptions that affect the reported amounts in the accompanying consolidated financial statements, disclosure of contingent assets and liabilities and related footnotes. Accounting and disclosure decisions with respect to material transactions that are subject to significant management judgments or estimates include impairment of long lived assets, deferred rent receivables, and allocation of purchase price relating to property acquisitions and the related depreciable lives assigned. Actual results may differ from these estimates under different assumptions or conditions.

Critical accounting policies are defined as those that require management to make estimates, judgments and assumptions, giving due consideration to materiality, in certain circumstances that affect amounts reported in the consolidated financial statements, and potentially result in materially different results under different conditions and assumptions. We believe that the following best describe our critical accounting policies:

REAL ESTATE ASSETS. Real estate assets are stated at cost. Cost includes expenditures for improvements or replacements. Maintenance and repairs are charged to expense as incurred. Gains and losses from sales are included in income in accordance with Statement of Financial Accounting Standard ("SFAS") No. 66, "Accounting for Sales of Real Estate."

BUSINESS COMBINATIONS. Statement of financial Accounting Standards No. 141 ("SFAS No. 141"), "Business Combinations," was effective July 1, 2001. The acquisition costs of each property acquired prior to July 1, 2001 were allocated only to building, land and leasing commissions with building depreciation being computed based on an estimated weighted average composite useful life of 40 years and leasing commissions amortization being computed over the term of the lease. Acquisitions of properties made subsequent to the effective date of SFAS No. 141 are based on an allocation of the acquisition cost to land, building, tenant improvements, and intangibles for at market and above market in place leases, and the determination of their useful lives are guided by a combination SFAS No. 141 and management's estimates. If we do not appropriately allocate these components or we incorrectly estimate the useful lives of these components, our computation of depreciation and amortization expense may not appropriately reflect the actual impact of these costs over future periods, which will affect net income.

IMPAIRMENT OF LONG-LIVED ASSETS. We review real estate assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable in accordance with Statement of Financial Accounting Standards No. 144 ("SFAS No. 144"), "Accounting for the Impairment and Disposal of Long-Lived Assets." If the carrying amount of the asset exceeds its estimated undiscounted net cash

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

flow, before interest, we will recognize an impairment loss equal to the difference between its carrying amount and its estimated fair value. If impairment is recognized, the reduced carrying amount of the asset will be accounted for as its new cost. For a depreciable asset, the new cost will be depreciated over the asset's remaining useful life. Generally, fair values are estimated using discounted cash flow, replacement cost or market comparison analyses. The process of evaluating for impairment requires estimates as to future events and conditions, which are subject to varying market factors, such as the vacancy rates, future rental rates and operating costs for R&D facilities in the Silicon Valley area and related submarkets. Therefore, it is reasonably possible that a change in estimate resulting from judgments as to future events could occur which would affect the recorded amounts of the property. As discussed in Note 16 to the consolidated financial statements, we recognized an impairment loss in 2004 on one asset held for sale under the application of this standard.

ALLOWANCE FOR DOUBTFUL ACCOUNTS AND DEFERRED RENT. The preparation of the consolidated financial statements requires us to make estimates and assumptions. As such, we must make estimates of the uncollectability of our accounts receivable based on the evaluation of our tenants' financial position, analyses of accounts receivable and current economic trends. We also make estimates for a straight-line adjustment reserve for existing tenants with the potential of early termination, bankruptcy or ceasing operations. Our estimates are based on our review of tenants' payment histories, publicly available financial information and such additional information about their financial condition as tenants provide to us. The information available to us might lead us to overstate or understate these reserve amounts. The use of different estimates or assumptions could produce different results. Moreover, actual future collections of accounts receivable or reductions in future reported rental income due to tenant bankruptcies or other business failures could differ materially from our estimates.

CONSOLIDATED JOINT VENTURES. We, through an operating partnership, own three properties that are in joint ventures of which we have controlling interests. We manage and operate all three properties. The recognition of these properties and their operating results are 100% reflected on our consolidated financial statements, with appropriate allocation to minority interest, because we have operational and financial control of the investments. We make judgments and assumptions about the estimated monthly payments made to our minority interest joint venture partners, which are reported with our periodic results of operations. Actual results may differ from these estimates under different assumptions or conditions.

- 28 -

INVESTMENT IN UNCONSOLIDATED JOINT VENTURE. We, through an operating partnership, have a 50% non-controlling limited partnership interest in one unconsolidated joint venture. This investment is not consolidated because the we do not exercise significant control over major operating and financial decisions. We account for the joint venture using the equity method of accounting.

REVENUE RECOGNITION. Rental revenue is recognized on the straight-line method of accounting required by GAAP under which contractual rent payment increases are recognized evenly over the lease term, regardless of when the rent payments are received by us. The difference between recognized rental income and rental cash receipts is recorded as Deferred Rent Receivable on the consolidated balance sheets.

Rental revenue is affected if existing tenants terminate or amend their

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

leases. We try to identify tenants who may be likely to declare bankruptcy or cease operations. By anticipating these events in advance, we expect to take steps to minimize their impact on our reported results of operations through lease renegotiations, reserves against deferred rent, and other appropriate measures. Our judgments and estimations about tenants' capacity to continue to meet their lease obligations will affect the rental revenue recognized. Material differences may result in the amount and timing of our rental revenue for any period if we made different judgments or estimations.

LEASE TERMINATION. Lease termination fees are recognized as other income when there is a signed termination letter agreement, all of the conditions of the agreement have been met, and the tenant is no longer occupying the property. These fees are paid by tenants who want to terminate their lease obligations before the end of the contractual term of the lease. There is no way of predicting or forecasting the timing or amounts of future lease termination fees.

We recognize income from rent, tenant reimbursements and lease termination fees and other income once all of the following criteria are met in accordance with SEC Staff Accounting Bulletin 104:

- the agreement has been fully executed and delivered;
- services have been rendered;
- the amount is fixed and determinable; and
- collectability is reasonably assured.

With regards to critical accounting policies, where applicable, we have explained and discussed the criteria for identification and selection, methodology in application and impact on the financial statements with the Audit Committee of our Board of Directors, which has reviewed these policies.

- 29 -

RESULTS OF OPERATIONS

COMPARISON OF THE YEAR ENDED DECEMBER 31, 2004 TO THE YEAR ENDED DECEMBER 31, 2003.

RENTAL REVENUE FROM CONTINUING PROPERTY OPERATIONS

As of December 31, 2004 and 2003, through our controlling interests in the operating partnerships, we owned 109 R&D properties totaling approximately 7.9 million rentable square feet. We did not purchase any new properties in 2004.

The following table depicts the amounts of rental revenue from continuing operations for the years ended December 31, 2004 and 2003 represented by our historical properties and the properties acquired in each such year and the percentage of the total increase in rental revenue over the period that is represented by each group of properties.

December 31,

2004

2003

\$ Change

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

		(dollars in thousands)	
Same Property (1)	\$107,851	\$121,411	(\$13,560)
2003 Acquisitions (2)	11,672	8,100	3,572
Total/Overall	\$119,523	\$129,511	(\$ 9,988)

- (1) "Same Property" is defined as properties owned by us prior to 2003 that we still owned as of December 31, 2004.
- (2) Operating rental revenue for 2003 Acquisitions do not reflect a full 12 months of operations in 2003 because these properties were acquired at various times during 2003. 2004 and 2003 amounts include approximately \$1.9 million and \$1.4 million, respectively, of above market rent amortization against rental revenue from real estate in connection with the implementation of SFAS No. 141.

For the year ended December 31, 2004, our rental revenue from real estate decreased by (\$10.0) million, or (7.7%) from \$129.5 million for the year ended December 31, 2003 to \$119.5 million for the same period in 2004. Pursuant to SFAS 141, \$1.9 million and \$1.4 million of amortization expense with respect to above-market leases included in the San Tomas Technology Park acquisition was offset against rental revenue and not separately stated as amortization expense for the years ended December 31, 2004 and 2003, respectively. The (\$10.0) million decrease in rental revenue resulted from adverse market conditions as "Same Property" rents decreased by (\$13.6) since our portfolio physical occupancy rate decreased by (6.6%) and average market rental rates decreased. However, rents from properties acquired in 2003 added approximately \$3.6 million of rental revenue due to a full 12 months of operations in 2004. The decline in rental revenue from the "Same Property" portfolio was a result from the loss of several tenants due to cessation of operations, tenant relocation or tenant requiring lesser space.

Our overall physical occupancy rate at December 31, 2004 and 2003 was approximately 70.7% and 77.3%, respectively. According to BT Commercial Real Estate, the occupancy rate for R&D property in the Silicon Valley at December 31, 2004 was approximately 77.6%. Due to an over supply of R&D properties and competition from other landlords in the Silicon Valley bidding for tenants, our occupancy rate may drop further in 2005 if the 501,000 rentable square feet scheduled to expire is not renewed or re-leased. Factors that contributed to our low physical occupancy rate are primarily the general downturn in the Silicon Valley's economy in recent years, the softening of our market specifically and the expected weaker performance of our properties.

EQUITY IN EARNINGS FROM UNCONSOLIDATED JOINT VENTURE

As of December 31, 2004, we had investments in four R&D buildings, totaling 593,000 rentable square feet in Morgan Hill, California, through an unconsolidated joint venture with TBI, in which we acquired a 50% interest from the Berg Group in January 2003. We have a non-controlling limited partnership interest in this joint venture, which we account for using the equity method of accounting. For the years ended December 31, 2004 and 2003, equity in earnings from the unconsolidated joint venture was approximately \$2.9 million (including \$1 million relating to lease termination income) and \$3.9 million (including \$1.4 million relating to a gain from the sale of real estate which was acquired from a related party which did not occur in 2004), respectively.

OTHER INCOME FROM CONTINUING PROPERTY OPERATIONS

The following table depicts the amounts of other income from continuing operations for the years ended December 31, 2004 and 2003.

	December 31,		\$ Change
	2004	2003	
	(dollars in thousands)		
Other income	\$6,914	\$4,527	\$2,387

Other income of approximately \$6.9 million for the year ended December 31, 2004 included approximately \$4.3 million from termination fees and \$1.2 million from tenant bankruptcy settlements. Other income of approximately \$4.5 million for 2003 included approximately \$2.2 million from tenant bankruptcy settlements.

EXPENSES FROM CONTINUING PROPERTY OPERATIONS

The following table reflects the increase in property operating and maintenance expenses and real estate taxes from continuing operations for the year ended December 31, 2004 over property operating and maintenance expenses and real estate taxes from continuing operations for the year ended December 31, 2003 and the percentage of total increase in expenses over the period that is represented by each group of properties.

	December 31,		\$ Change
	2004	2003	
	(dollars in thousands)		
Same Property (1)	\$18,192	\$19,638	(\$1,446)
2003 Acquisitions (2)	2,348	1,582	766
Total/Overall	\$20,540	\$21,220	(\$680)

- (1) "Same Property" is defined as properties owned by us prior to 2003 that we still owned as of December 31, 2004.
- (2) Operating expenses and real estate taxes for 2003 Acquisitions do not reflect a full 12 months of operations in 2003 because these properties were acquired at various times during 2003.

Operating expenses and real estate taxes from continuing operations, on a

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

combined basis, decreased by (\$0.7) million, or (3.2%), from \$21.2 million for the year ended December 31, 2003 to \$20.5 million for the year ended December 31, 2004. Tenant reimbursements from continuing operations decreased by (\$3.8) million, or (20.2%), from \$18.7 million for the year ended December 31, 2003 to \$14.9 million for the year ended December 31, 2004. The overall decrease in tenant reimbursements, operating expenses and real estate taxes resulted primarily from reductions in assessed property values on existing properties as a result of property tax appeals that we filed under California's Proposition 8 and lower occupancy during the periods presented. Total operating expenses and real estate taxes exceeded tenant reimbursements because of vacancies, which reached approximately 2.3 million rentable square feet by year-end 2004. Certain expenses such as property insurance, real estate taxes, and other fixed expenses are not recoverable from vacant properties. We expect tenant reimbursements to decrease further in the coming year as our vacancy rate increases. At December 31, 2004 our vacancy rate was 29%.

General and administrative expenses increased by approximately \$0.7 million, 51.9%, from \$1.3 million for the year ended December 31, 2003 to \$2.0 million for the year ended December 31, 2004, primarily due to incurring additional legal and accounting expenses in connection with the resignation of PricewaterhouseCoopers LLP, our former independent accountants, the need to re-audit the consolidated financial statements for years 2001 and 2002 and audit 2003 results, and expenses related to the compliance with Section 404 of the Sarbanes-Oxley Act of 2002.

The following table depicts the amounts of depreciation and amortization expense of real estate from continuing operations for the years ended December 31, 2004 and 2003.

	December 31,		
	2004	2003	\$ Change
	(dollars in thousands)		
Depreciation & amortization	\$21,669	\$20,525	\$1,144

- 31 -

Depreciation and amortization expense of real estate from continuing operations increased by \$1.1 million, or 5.6%, from \$20.5 million for the year ended December 31, 2003 to \$21.6 million for the year ended December 31, 2004. The increase was attributable to the recognition of a full year of depreciation from the acquisition of eight R&D properties in 2003. Of the \$1.1 million increase in depreciation and amortization expense of real estate, approximately \$0.7 million represented amortization expense for in place leases comprising a portion of the value of the assets acquired in the acquisitions of the Orchard-Trimble property and the San Tomas Technology Park.

The following table depicts the amounts of interest expense from continuing operations for the years ended December 31, 2004 and 2003.

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

	December 31,		\$ Change
	2004	2003	
	(dollars in thousands)		
Interest	\$17,581	\$16,446	\$1,135
Interest (related parties)	1,077	1,064	13
Total	\$18,658	\$17,510	\$1,148

Interest expense increased by \$1.1 million, or 6.9%, from \$16.5 million for the year ended December 31, 2003 to \$17.6 million for the year ended December 31, 2004. The increased expense resulted from additional debt that the Company incurred under a new \$80 million collateralized loan obtained from Citicorp USA, Inc. in 2003 and a \$40 million line of credit established with Cupertino National Bank, the proceeds of which were used primarily for the acquisition of the San Tomas Technology Park in 2003. Interest expense (related parties) increased by \$13,000, or 1.2%, primarily due to higher interest rates of 4.08% at December 31, 2004 compared to 2.52% at December 31, 2003.

The new debt carries a higher interest rate than the Berg Group line of credit, which it mainly replaced, contributing to the increase in interest expense for the year. We anticipate additional increases in interest expense as new debt is incurred in connection with property acquisitions and we draw on the Cupertino National Bank revolving line of credit.

NET INCOME TO COMMON STOCKHOLDERS AND NET INCOME TO MINORITY INTERESTS

The following table depicts the amounts of earnings attributable to common stockholders and minority interests for the years ended December 31, 2004 and 2003.

	December 31,		\$ Chan
	2004	2003	
	(dollars in thousands)		
Net income to shareholders	\$13,312	\$16,212	(\$ 2,9
Net income to minority interests	66,100	80,836	(14,7
Total	\$79,412	\$97,048	(\$17,6

As of December 31, 2004 and 2003, we owned a general partnership interest of 17.16%, 21.63%, 16.14% and 12.38% and 16.95%, 21.61%, 15.98% and 12.37% in the four operating partnerships, Mission West Properties, L.P., Mission West Properties, L.P. I, Mission West Properties, L.P. II and Mission West Properties, L.P. III, respectively. We owned a 17.26% and 17.02% general partnership interest in the operating partnerships, taken as a whole, on a weighted average basis as of December 31, 2004 and 2003, respectively. Net income to common stockholders decreased by (\$2.9) million, or (17.9%), from

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

\$16.2 million for the year ended December 31, 2003 to \$13.3 million for the year ended December 31, 2004. Our net income attributable to minority interests decreased by (\$14.7) million, or (18.2%), from \$80.8 million for the year ended December 31, 2003 to \$66.1 million for the year ended December 31, 2004. The decrease in net income attributable to common stockholders and minority interests is primarily due to lower income from continuing operations as a result of the decrease in revenues and increase in expenses as previously discussed above. Minority interest represents the limited partners' ownership interest of 82.74% and 82.98% in the operating partnerships, on a weighted average basis, as of December 31, 2004 and 2003, respectively. The decrease in the minority interest percentage resulted from the issuance of additional shares of common stock from the exchange of O.P. Units for common stocks by minority interest holders and the exercise of stock options.

- 32 -

INCOME/(LOSS) FROM DISCONTINUED OPERATIONS

The following table depicts the amounts of income/(loss) from discontinued operations for the years ended December 31, 2004 and 2003.

	December 31, 2004	December 31, 2003
	(dollars in thousands)	
Income/(loss) attributable to discontinued operations	(\$2,041)	\$ 979
Minority interest in earnings attributable to discontinued operations	1,600	(768)
	-----	-----
Total income/(loss) from discontinued operations	(\$ 441)	\$ 211

In accordance with our adoption of SFAS No. 144, in 2004 we classified a property consisting of 75,000 rentable square feet separately as an asset held for sale on the accompanying consolidated balance sheets and reported the operating results of the asset held for sale as discontinued operations on the accompanying consolidated statements of operations. As of December 31, 2004, management believed that the asset held for sale was impaired as the asset's net book value exceeded the expected net sale price of the asset. We decided to sell that property after an unsolicited offer was made from an unrelated third party. An impairment charge of approximately (\$2.2) million was recorded to reduce the carrying value of the asset to its fair value, less selling costs. We sold this property on January 5, 2005 for \$8.5 million. Also see Note 19, "Subsequent Events," to the consolidated financial statements

SFAS No. 144 requires prior period results of operations for this property to be restated and presented in discontinued operations in prior consolidated statements of operations.

We recognized total loss of (\$2.0) million from discontinued operations, of which (\$0.4) million and (\$1.6) million were attributable to common

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

stockholders and minority interests, respectively, for the year ended December 31, 2004. For the year ended December 31, 2003, we recognized total income from discontinued operations of \$1.0 million. The year over year change resulted primarily from the (\$2.2) million impairment charge discussed above as well as a tenant vacancy that occurred during the second quarter of 2004. The income to common stockholders and minority interests attributable to discontinued operation from this property in 2003 was approximately \$0.2 million and \$0.8 million, respectively.

- 33 -

COMPARISON OF THE YEAR ENDED DECEMBER 31, 2003 TO THE YEAR ENDED DECEMBER 31, 2002.

RENTAL REVENUE FROM CONTINUING PROPERTY OPERATIONS

As of December 31, 2003, through our controlling interests in the operating partnerships, we owned 109 R&D properties totaling approximately 7.9 million rentable square feet compared to 101 such properties totaling approximately 7.2 million rentable square feet as of December 31, 2002. This represented a net increase of approximately 10% in total rentable square footage from the prior year. During 2003, we made the following acquisitions by purchase of new properties from unrelated parties or under the Berg Land Holdings Option Agreement.

Date of Acquisition	Address	Rentable Square Footage
-----	-----	-----
4/03	2001 Walsh Avenue	80,000
4/03	2880 Scott Boulevard	200,000
4/03	2890 Scott Boulevard	75,000
4/03	2770-2800 Scott Boulevard	98,430
4/03	2300 Central Expressway	46,338
4/03	2220 Central Expressway	62,522
4/03	2330 Central Expressway	62,522
12/03	5970 Optical Court	128,520
	Total	----- 753,332 -----

The following table depicts the amounts of rental revenue from continuing operations for the years ended December 31, 2003 and 2002 represented by our historical properties and the properties acquired in each such year and the percentage of the total increase in rental revenue over the period that is represented by each group of properties.

December 31,		
-----	-----	-----
2003	2002	\$ Change
-----	-----	-----
(dollars in thousands)		

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

Same Property (1)	\$111,201	\$120,176	(\$8,975)
2002 Acquisitions (2)	10,212	8,377	1,835
2003 Acquisitions (3)	8,098	-	8,098
	-----	-----	-----
Total/Overall	\$129,511	\$128,553	\$ 958
	=====	=====	=====

- (1) "Same Property" is defined as properties owned by us prior to 2002 that we still owned as of December 31, 2003.
- (2) Operating rental revenue for 2002 Acquisitions do not reflect a full 12 months of operations in 2002 because these properties were acquired at various times during 2002.
- (3) Operating rental revenue for 2003 Acquisitions do not reflect a full 12 months of operations in 2003 because these properties were acquired at various times during 2003. 2003 amount includes approximately \$1.4 million of above market rent amortization against rental revenue from real estate in connection with the implementation of SFAS No. 141.

For the year ended December 31, 2003, our rental revenue from real estate increased by \$0.9 million, or 0.7% from \$128.6 million for the year ended December 31, 2002 to \$129.5 million for the same period in 2003. Pursuant to SFAS 141, \$1.4 million of amortization expense with respect to above-market leases included in the San Tomas Technology Park acquisition was offset against rental revenue and not separately stated as amortization expense in 2003. The \$0.9 million increase in rental revenue resulted from new property acquisitions, as "Same Property" rents decreased by (\$9.0), rents from newly developed properties acquired in 2002 represented an increase of \$1.8 million and rents from newly developed properties acquired in 2003 added approximately \$8.1 million of new rental revenue. The decline in rental revenue from the "Same Property" portfolio was a result from adverse market conditions and loss of several tenants due to bankruptcy, cessation of operations, or tenant relocation. Our overall physical occupancy rate at December 31, 2003 and 2002 was approximately 77.3% and 83.8%, respectively.

EQUITY IN EARNINGS FROM UNCONSOLIDATED JOINT VENTURE

As of December 31, 2003, we had investments in four R&D buildings, totaling 593,000 rentable square feet in Morgan Hill, California, through an unconsolidated joint venture with TBI, in which we acquired a 50% interest from the Berg Group in January 2003. We have a non-controlling limited partnership interest in this joint venture, which we account for using the equity method of accounting. For the year ended December 31, 2003, equity in earnings from the unconsolidated joint venture was approximately \$3.9 million, including \$1.4 million relating to a gain from the sale of real estate, which was acquired from a related party.

- 34 -

OTHER INCOME

The following table depicts the amounts of other income from continuing operations for the years ended December 31, 2003 and 2002.

December 31,

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

	2003	2002	\$ Change
	-----	-----	-----
	(dollars in thousands)		
Other income	\$4,527	\$4,248	\$279

Other income, including interest, was approximately \$4.5 million and \$4.2 million for the years ended December 31, 2003 and 2002, respectively. Included in the \$4.5 million is approximately \$2.2 million from tenant bankruptcy settlements. Included in the \$4.2 million is approximately \$2.4 million in termination fees. The \$0.3 million increase represented utility rebate and security deposit forfeitures.

EXPENSES FROM CONTINUING PROPERTY OPERATIONS

The following table reflects the increase in property operating and maintenance expenses and real estate taxes from continuing operations for the year ended December 31, 2003 over property operating and maintenance expenses and real estate taxes from continuing operations for the year ended December 31, 2002 and the percentage of total increase in expenses over the period that is represented by each group of properties.

	December 31,		
	-----	-----	-----
	2003	2002	\$ Change
	-----	-----	-----
	(dollars in thousands)		
Same Property (1)	\$17,844	\$22,482	(\$4,638)
2002 Acquisitions (2)	1,794	1,327	467
2003 Acquisitions (3)	1,582	-	1,582
	-----	-----	-----
Total/Overall	\$21,220	\$23,809	(\$2,589)
	=====	=====	=====

- (1) "Same Property" is defined as properties owned by us prior to 2002 that we still owned as of December 31, 2003.
- (2) Operating expenses and real estate taxes for 2002 Acquisitions do not reflect a full 12 months of operations in 2002 because these properties were acquired at various times during 2002.
- (3) Operating expenses and real estate taxes for 2003 Acquisitions do not reflect a full 12 months of operations in 2003 because these properties were acquired at various times during 2003.

Operating expenses and real estate taxes from continuing operations, on a combined basis, decreased by (\$2.6) million, or (10.9%), from \$23.8 million for the year ended December 31, 2002 to \$21.2 million for the year ended December 31, 2003. Tenant reimbursements from continuing operations decreased by (\$1.2) million, or (6.2%), from \$19.9 million for the year ended December 31, 2002 to \$18.7 million for the year ended December 31, 2003. The overall decrease in tenant reimbursements, operating expenses and real estate taxes is primarily a result of the reductions in assessed property values on existing properties as a result of property tax appeals that we filed under California's Proposition 8 and lower occupancy during the periods presented. Reductions in property tax assessments as a result of appeals filed under Proposition 8 can be immediately increased to

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

pre-Proposition 8 assessed values when the County Assessor determines market conditions have improved. Total operating expenses and real estate taxes exceeded tenant reimbursements because of vacancies, which reached approximately 1.8 million rentable square feet by year-end 2003. Certain expenses such as property insurance, real estate taxes, and other fixed expenses are not recoverable from vacant properties. We expect tenant reimbursements to decrease further in the coming year as our vacancy rate increases. At December 31, 2003 our vacancy rate was 23%. General and administrative expenses decreased by approximately (\$0.2) million, or (11%), from \$1.5 million for the year ended December 31, 2002 to \$1.3 million for the year ended December 31, 2003, primarily due to the loss of one employee and the decrease of legal fees in 2003.

The following table depicts the amounts of depreciation and amortization expense of real estate from continuing operations for the years ended December 31, 2003 and 2002.

	December 31,		\$ Change
	2003	2002	
	(dollars in thousands)		
Depreciation & amortization	\$20,525	\$18,064	\$2,461

- 35 -

Depreciation and amortization expense of real estate from continuing operations increased by \$2.5 million, or 13.6%, from \$18 million for the year ended December 31, 2002 to \$20.5 million for the year ended December 31, 2003. The increase was attributable to the acquisition of eight R&D properties in 2003. Of the \$2.5 million increase in depreciation and amortization expense of real estate, approximately \$1 million represented amortization expense for in place leases comprising a portion of the value of the assets acquired in the acquisitions of the Orchard-Trimble property and the San Tomas Technology Park.

The following table depicts the amounts of interest expense from continuing operations for the years ended December 31, 2003 and 2002.

	December 31,		\$ Change
	2003	2002	
	(dollars in thousands)		
Interest	\$16,446	\$ 9,588	\$6,858
Interest (related parties)	1,064	3,422	(2,358)
Total	\$17,510	\$13,010	\$4,500

Interest expense increased by \$6.8 million, or 71.5%, from \$9.6 million for the year ended December 31, 2002 to \$16.4 million for the year ended

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

December 31, 2003. The increased expense resulted from additional debt that the Company incurred under a new \$100 million collateralized loan obtained from Northwestern Mutual Life Insurance Company, an \$80 million collateralized loan obtained from Citicorp USA, Inc. and a \$40 million line of credit established with Cupertino National Bank, the proceeds of which were used primarily for the acquisition of the San Tomas Technology Park. Interest expense (related parties) decreased by (\$2.3) million, or (68.9%), from \$3.4 million for the year ended December 31, 2002 to \$1.1 million for the year ended December 31, 2003 primarily due to the refinancing of a portion of the related party debt with the new third party financing discussed above.

The new debt carries a higher interest rate than the Berg Group line of credit, which it mainly replaced, contributing to the increase in interest expense for the year. We anticipate additional increases in interest expense as new debt is incurred in connection with property acquisitions and we draw on the Cupertino National Bank revolving line of credit.

NET INCOME TO COMMON STOCKHOLDERS AND NET INCOME TO MINORITY INTERESTS

The following table depicts the amounts of earnings attributable to common stockholders and minority interests for the years ended December 31, 2003 and 2002.

	December 31,		
	2003	2002	\$ Chan
	(dollars in thousands)		
Net income to shareholders	\$16,212	\$ 17,115	(\$ 9
Net income to minority interests	80,836	86,641	(5,8
Total	\$97,048	\$103,756	(\$ 6,7

As of December 31, 2003 and 2002, we owned a general partnership interest of 16.95%, 21.61%, 15.98% and 12.37% and 16.68%, 21.46%, 15.46% and 12.27% in the four operating partnerships, Mission West Properties, L.P., Mission West Properties, L.P. I, Mission West Properties, L.P. II and Mission West Properties, L.P. III, respectively. We owned a 17.02% and 16.82% general partnership interest in the operating partnerships, taken as a whole, on a weighted average basis as of December 31, 2003 and 2002, respectively. Net income to common stockholders decreased by (\$0.9) million, or (5.3%), from \$17.1 million for the year ended December 31, 2002 to \$16.2 million for the year ended December 31, 2003. Our net income attributable to minority interests decreased by (\$5.8) million, or (6.7%), from \$86.6 million for the year ended December 31, 2002 to \$80.8 million for the year ended December 31, 2003. Minority interest represents the limited partners' ownership interest of 82.98% and 83.18% in the operating partnerships, on a weighted average basis, as of December 31, 2003 and 2002, respectively. The decrease in the minority interest percentage resulted from the issuance of additional shares of common stock from the exchange of O.P. Units for common stock by minority interest holders and the exercise of stock options.

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

INCOME FROM DISCONTINUED OPERATIONS

The following table depicts the amounts of income from discontinued operations for the years ended December 31, 2003 and 2002.

	December 31, 2003	December 31, 2002
	(dollars in thousands)	
Gain from disposal of discontinued operations	-	\$ 6,103
Income attributable to discontinued operations	\$ 979	1,266
Minority interest in earnings attributable to discontinued operations	(768)	(6,093)
	\$ 211	\$ 1,276
	\$ 211	\$ 1,276

In accordance with our adoption of SFAS No. 144, in 2004 we classified a 75,000 rentable square feet property separately as an asset held for sale on the accompanying consolidated balance sheets and reported the operating results of the asset held for sale as a discontinued operation on the accompanying consolidated statements of operations. Also in accordance with our adoption of SFAS No. 144, in 2002 we sold one property consisting of 72,426 rentable square feet and classified the gain on sale and operating results of the disposed property as discontinued operations.

SFAS No. 144 requires prior period results of operations for these properties to be restated and presented in discontinued operations in prior consolidated statements of operations.

We recognized total income of \$1 million from discontinued operations, of which \$0.2 million and \$0.8 million were attributable to common stockholders and minority interests, respectively, for the year ended December 31, 2003. For the year ended December 31, 2002, we recognized total income from discontinued operations of \$7.4 million, including \$6.1 million gain on sale of real estate. The income to common stockholders and minority interests attributable to discontinued operations from these properties in 2002 was approximately \$1.3 million and \$6.1 million, respectively.

- 37 -

CHANGES IN FINANCIAL CONDITION

YEAR ENDED DECEMBER 31, 2004.

The most significant changes in our financial condition in 2004 resulted from the exercise of stock options and the exchange of O.P. Units for shares of common stock.

Debt outstanding, including amounts due related parties, decreased by (\$3.9) million, or (1.1%), from \$340.9 million as of December 31, 2003 to \$337.0 million as of December 31, 2004 due to recurring debt service

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

obligations. Interest rates continued to remain low in 2004.

During the year ended December 31, 2004, stock options were exercised to purchase a total of 20,000 shares of common stock, consisting of 20,000 shares exercised at \$8.25 per share. Total proceeds to the Company were approximately \$165,000.

In 2004, three limited partners exchanged 124,500 O.P. Units for 124,500 shares of the Company's common stock under the terms of the December 1998 Exchange Rights Agreement among the Company and the limited partners of the operating partnerships. In 2004, Carl E. Berg gave 58,000 O.P. Units to charitable institutions that exchanged them for 58,000 shares of the Company's common stock pursuant to the December 1998 Exchange Rights Agreement.

The proceeds from the exercise of stock options and the conversion of O.P. Units to shares of the Company's common stock were applied to increase our percentage interest as general partner in the operating partnerships.

YEAR ENDED DECEMBER 31, 2003.

The most significant changes in our financial condition in 2003 resulted from property acquisitions. In addition, stockholders' equity increased from the exercise of stock options and the exchange of O.P. Units for common stock.

During 2003, we acquired one R&D property and a 50% interest in the Morgan Hill joint venture with TBI from the Berg Group. Those acquisitions added approximately 129,000 square feet of rentable space and were acquired under the Berg Land Holdings Option Agreement. The total gross acquisition price was approximately \$13.0 million. We financed those acquisitions by borrowing \$9 million under our line of credit from the Berg Group and issuing 350,163 O.P. Units to various members of the Berg Group. In addition to those two purchases, we also acquired the San Tomas Technology Park, which was financed with a combination of an \$80 million mortgage note at LIBOR plus 200 basis points, cash reserves, and cash proceeds from our line of credit with Cupertino National Bank. This acquisition added approximately 625,000 rentable square feet to our portfolio.

As a result of those property acquisitions, debt outstanding, including amounts due related parties, increased by \$102.1 million, or 42.8%, from \$238.8 million as of December 31, 2002 to \$340.9 million as of December 31, 2003. Interest rates continued to remain low in 2003, which lessened the effect of the additional debt on total interest expense. We expect interest expense to increase if we acquire additional properties or interest rates increase in 2004.

During the year ended December 31, 2003, stock options were exercised to purchase a total of 150,362 shares of common stock, consisting of 60,362 shares exercised at \$4.50 per share and 90,000 shares exercised at \$8.25 per share. Total proceeds to the Company were approximately \$1 million.

In 2003, three limited partners exchanged 257,000 O.P. Units for 257,000 shares of the Company's common stock under the terms of the December 1998 Exchange Rights Agreement among the Company and the limited partners of the operating partnerships.

The proceeds from the exercise of stock options and the conversion of O.P. Units to shares of the Company's common stock were applied to increase our percentage interest as general partner in the operating partnerships.

LIQUIDITY AND CAPITAL RESOURCES

In 2005 we anticipate a decline in operating cash flows from our operating property portfolio compared to 2004 because of reduced demand for R&D space in the Silicon Valley, lower rental rates for new and renewed leases signed in 2004 and an increase in vacant properties in 2004. In addition, if we are unable to lease a significant portion of the approximately 501,000 rentable square feet scheduled to expire in 2005 and current available space, our operating cash flows would be further affected adversely. With the expectation of lower revenues for the full year of 2005, we expect our net operating income to continue to decline from 2004. We are also subject to risks of decreased occupancy through tenant defaults and bankruptcies, and potential reduction in rental rates upon renewal of properties, which would result in reduction in cash flows from operations beyond the level we are anticipating currently. It is reasonably likely that vacancy rates may continue to increase and effective rental rates on new and renewed leases may continue to decrease in 2005.

We expect our principal source of liquidity for distributions to stockholders and O.P. Unit holders, debt service, leasing commissions and recurring capital expenditures to come from cash provided by operations and/or the borrowings under the lines of credit with the Berg Group and Cupertino National Bank. We expect these sources of liquidity to be adequate to meet projected distributions to stockholders and other presently anticipated liquidity requirements in 2005. We expect to meet our long-term liquidity requirements for the funding of property development, property acquisitions and other material non-recurring capital improvements through long-term secured and unsecured indebtedness and the issuance of additional equity securities by us. As of December 31, 2004 and 2003, the Company's total debt as a percentage of total market capitalization was 23.3% and 20.1%, respectively. We have the ability to meet short-term obligations or other liquidity needs based on lines of credit with the Berg Group and Cupertino National Bank. Despite the current weakness in the economy, we expect our total interest expense to increase as interest rates rise and through new financing activities. In 2005, we will be obligated to make payments totaling approximately \$8.3 million of debt principal under mortgage notes without regard to any debt refinancing or new debt obligations that we might incur, or optional payments of debt principal.

Effective January 1, 2003, the Company and the Berg Group mutually agreed to reduce the Berg Group \$100 million line of credit to \$20 million and to reduce the number of properties securing the line of credit to five. The Berg Group line of credit bears interest at LIBOR plus 1.30%, which was 4.08% as of December 31, 2004, and matures in March 2006. Debt of \$9.6 million under this line of credit was outstanding at December 31, 2004. We believe that the terms of the Berg Group line of credit were more favorable than those available from institutional lenders. We are continually evaluating alternative sources of credit to replace the Berg Group line of credit. There can be no assurance that we will be able to obtain a line of credit with terms similar to the Berg Group line of credit, and its cost of borrowing could increase substantially. See Item 1, "Business - Risk Factors - Our contractual business relationships with the Berg Group presents additional conflicts of interest which may result in the realization of economic benefits or the deferral of tax liabilities by the Berg Group without equivalent benefits to our stockholders."

On April 9, 2003, we obtained an \$80 million short-term mortgage loan from Citicorp USA, Inc. ("Citicorp Loan") that bears interest at LIBOR plus 2%

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

and originally matured on March 29, 2004. We and Citicorp agreed to extend the loan to May 27, 2004 and again to September 6, 2004. On October 14, 2004, we concluded the extension of the Citicorp Loan for an additional two years until September 6, 2006. The Citicorp Loan requires monthly principal payments of \$215,000 and carries a variable interest rate of LIBOR plus 2%. The loan fee and costs incurred in connection with the mortgage loan extension amounted to approximately \$142,000 and will be amortized over the term of the loan. Under the previous loan terms, Carl E. Berg had personally guaranteed our repayment obligations and provided a personal guaranty of our obligation to indemnify the lender for certain potential environmental liabilities with respect to the pledged properties. Those guaranties were provided in conjunction with Citicorp's short-term loan of \$80 million for our acquisition of the San Tomas Technology Park and were released by Citicorp as part of the most recent loan extension. The Citicorp Loan is secured by eight of our properties. The Citicorp Loan terms require us to maintain a minimum excess of assets over liabilities of \$400 million, in addition to complying with other customary loan covenants and conditions. In connection with the extension of the Citicorp Loan, we retired an 8.75% mortgage loan from Prudential Capital Group with \$548,000 of outstanding principal in October 2004, which had been collateralized by one property located at 20400 Mariani Avenue in Cupertino, California. This property has been added as additional collateral under the Citicorp Loan.

We have a \$40 million line of credit with Cupertino National Bank ("CNB") that expires on November 2, 2006. We are the borrower under the CNB line of credit which is guaranteed by Mission West Properties, L.P. and Mission West Properties, L.P. II.

The CNB line of credit and Citicorp Loan contain certain financial loan and reporting covenants as defined in the loan agreements. As of December 31, 2004, we were in compliance with these loan covenants.

Since 1999, we have elected to be taxed as a REIT under the Internal Revenue Code of 1986. We currently intend to continue operating as a REIT in 2005. As a REIT, we are subject to a number of organizational and operating requirements, including a

- 39 -

requirement to distribute 90% of our taxable income to our shareholders. As a REIT, we generally will not be subject to federal income taxes on our taxable income.

Generally, our objective is to meet our short-term liquidity requirement of funding the payment of our current level of quarterly common dividends to shareholders and O.P. Unit holders through our net cash flows provided by operating activities, less our recurring and nonrecurring property capital expenditures. These operating capital expenditures are the capital expenditures necessary to maintain the earnings capacity of our operating assets over time.

In order to better align with this objective in 2005, we reduced our quarterly dividend payment rate to common shareholders and O.P. Unit holders from a rate of \$0.24 per share to \$0.16 per share effective with the quarterly dividend paid for the fourth quarter of 2004. The factors that led to the fourth quarter 2004 dividend reduction were the decline in economic and market conditions in the Silicon Valley, the reduction in Microsoft's rent under its new lease and the slower lease-up of vacant properties resulting in lower cash flow from our operating property portfolio. For 2005, we expect to maintain our current quarterly dividend payment rate to common shareholders and O.P. Unit holders of \$0.16 per

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

share. However, distributions are declared at the discretion of our Board of Directors and are subject to actual cash available for distribution, our financial condition, capital requirements and such other factors, as our Board of Directors deems relevant.

On January 7, 2005, we paid dividends of \$0.16 per share of common stock to all common stockholders of record as of December 31, 2004. On the same date, the operating partnerships paid a distribution of \$0.16 per O.P. Unit to all holders of O.P. Units.

CONTRACTUAL OBLIGATIONS

The following table identifies our contractual obligations as of December 31, 2004 that will impact our liquidity and cash flow in future periods:

	2005	2006	2007	2008
	(dollars in thousands)			
Long-Term Debt Obligations (1)	\$8,284	\$115,940	\$6,350	\$116,674
Operating Lease Obligations (2)	90	90	23	-
Total	\$8,374	\$116,030	\$6,373	\$116,674

- (1) Our long-term debt obligations are set forth in detail in the schedule below.
- (2) Our operating lease obligations relate to a lease of our corporate office facility from a related party.

At December 31, 2004, we had total indebtedness of approximately \$337 million, including approximately \$224.5 million of fixed rate mortgage debt and approximately \$112.5 million under the loan from Citicorp USA, Inc. and the lines of credit from the Berg Group and Cupertino National Bank, as to which the interest rate varies with LIBOR. Of total fixed debt, the Prudential and Northwestern loans represented approximately \$119.4 million and \$94.5 million, respectively.

- 40 -

The following table sets forth certain information regarding debt outstanding as of December 31, 2004.

Debt Description	Collateral Properties	At Dec 2
(dollars in		
Line of Credit:		
Berg Group (related parties)	2033-2043 Samaritan Drive, San Jose, CA 2133 Samaritan Drive, San Jose, CA 2233-2243 Samaritan Drive, San Jose, CA 1310-1450 McCandless Drive, Milpitas, CA 1795-1845 McCandless Drive, Milpitas, CA	\$ 9 -----

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

Cupertino National Bank	Not Applicable	24

Mortgage Notes Payable (related parties):	5300-5350 Hellyer Avenue, San Jose, CA	10

Mortgage Notes Payable (2):		
Washington Mutual	10460 Bubb Road, Cupertino, CA	
Prudential Insurance Company of America	10300 Bubb Road, Cupertino, CA	119
(3)	10500 North De Anza Blvd, Cupertino, CA	
	4050 Starboard Drive, Fremont, CA	
	45700 Northport Loop, Fremont, CA	
	45738 Northport Loop, Fremont, CA	
	450 National Ave, Mountain View, CA	
	6311 San Ignacio Avenue, San Jose, CA	
	6321 San Ignacio Avenue, San Jose, CA	
	6325 San Ignacio Avenue, San Jose, CA	
	6331 San Ignacio Avenue, San Jose, CA	
	6341 San Ignacio Avenue, San Jose, CA	
	6351 San Ignacio Avenue, San Jose, CA	
	3236 Scott Blvd, Santa Clara, CA	
	3560 Bassett Street, Santa Clara, CA	
	3570 Bassett Street, Santa Clara, CA	
	3580 Bassett Street, Santa Clara, CA	
	1135 Kern Avenue, Sunnyvale, CA	
	1212 Bordeaux Lane, Sunnyvale, CA	
	1230 East Arques, Sunnyvale, CA	
	1250 East Arques, Sunnyvale, CA	
	1170 Morse Avenue, Sunnyvale, CA	
	1600 Memorex Drive, Santa Clara, CA	
	1688 Richard Avenue, Santa Clara, CA	
	1700 Richard Avenue, Santa Clara, CA	
	3540 Bassett Street, Santa Clara, CA	
	3542 Bassett Street, Santa Clara, CA	
	3544 Bassett Street, Santa Clara, CA	
	3550 Bassett Street, Santa Clara, CA	
Northwestern Mutual Life Ins. Co.(5)	1750 Automation Parkway, San Jose, CA	94
	1756 Automation Parkway, San Jose, CA	
	1762 Automation Parkway, San Jose, CA	
	6320 San Ignacio Avenue, San Jose, CA	
	6540-6541 Via Del Oro, San Jose, CA	
	6385-6387 San Ignacio Ave., San Jose, CA	
	2251 Lawson Lane, Santa Clara, CA	
	1325 McCandless Drive, Milpitas, CA	
	1650-1690 McCandless Drive, Milpitas, CA	
	20605-20705 Valley Green Dr., Cupertino, CA	
Citicorp USA, Inc.	2001 Walsh Avenue, Santa Clara, CA	78
	2880 Scott Boulevard, Santa Clara, CA	
	2890 Scott Boulevard, Santa Clara, CA	
	2770-2800 Scott Boulevard, Santa Clara, CA	
	2220 Central Expressway, Santa Clara, CA	
	2300 Central Expressway, Santa Clara, CA	
	2330 Central Expressway, Santa Clara, CA	
	20400 Mariani Avenue, Cupertino, CA	

Mortgage Notes Payable		292

Total

\$337
=====

- 41 -

- (1) The debt owed to the Berg Group under the line of credit carries a variable interest rate equal to LIBOR plus 1.30% and is payable in full in March 2006. The interest rate was 4.08% at December 31, 2004.
- (2) Mortgage notes payable generally require monthly installments of interest and principal ranging from \$8 to \$827 over various terms extending through the year 2013. The weighted average interest rate of mortgage notes payable was 6.23% at December 31, 2004.
- (3) The Prudential Insurance loan is payable in monthly installments of \$827, which includes principal (based upon a 30-year amortization) and interest. A limited partner, who is not a member of the Berg Group, has guaranteed approximately \$12 million of this debt. Costs and fees incurred with obtaining this loan aggregated approximately \$900, which were deferred and amortized over the loan period.
- (4) Interest rate equal to LIBOR plus 2%. The interest rate for the Cupertino National Bank line of credit and the Citicorp USA, Inc. mortgage loan at December 31, 2004 was 4.29% and 4.18%, respectively. As of December 31, 2004, we were in compliance with the financial covenants under each loan agreement.
- (5) The Northwestern loan is payable in monthly installments of \$696, which includes principal (based upon a 20-year amortization) and interest. Costs and fees incurred with obtaining this loan aggregated approximately \$675, which were deferred and amortized over the loan period.

At December 31, 2004, our debt to total market capitalization ratio, which is computed as our total debt outstanding divided by the sum of total debt outstanding plus the market value of common stock (based upon the closing price of \$10.64 per share on December 31, 2004) on a fully diluted basis, including the conversion of all O.P. Units into common stock, was approximately 23.3%. On December 31, 2004, the last trading day for the year, total market capitalization was approximately \$1.45 billion.

At December 31, 2004, the outstanding balance remaining under certain demand notes that we owed to the operating partnerships was \$1.59 million. The due date of the demand notes has been extended to September 30, 2006. The principal of the demand notes, along with the interest expense, which is interest income to the operating partnerships, is eliminated in consolidation and is not included in the corresponding line items within the consolidated financial statements. However, the interest income earned by the operating partnerships, which is interest expense to us, in connection with this debt, is included in the calculation of minority interest as reported on the consolidated statement of operations, thereby reducing our net income by this same amount. At present, our only means for repayment of this debt is through distributions that we receive from the operating partnerships that are in excess of the amount of dividends to be paid to our stockholders.

- 42 -

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

HISTORICAL CASH FLOWS

COMPARISON OF THE YEAR ENDED DECEMBER 31, 2004 TO THE YEAR ENDED DECEMBER 31, 2003.

Net cash provided by operating activities for the year ended December 31, 2004 was approximately \$105.1 million, compared to approximately \$116.5 million for the prior year. The decrease in cash provided by operating activities resulted from lower market rental rates, reductions in tenant expense reimbursements and the loss of several tenants due to their lease default, cessation of operations, or relocations resulting in increased vacancy rates that offset cash savings.

Net cash used in investing activities for improvements to real estate was approximately (\$1.5) million for the year ended December 31, 2004, compared to approximately (\$110) million for the prior year. Cash used in investing activities during 2003 related to financing the acquisition of the San Tomas Technology Park of \$110 million as well as new equipment and improvements of \$1.4 million.

Net cash used in financing activities was approximately (\$106.2) million for the year ended December 31, 2004, compared to (\$6.9) million for the year ended December 31, 2003. During 2004, we paid debt principal and made distributions to holders of our common stock and O.P. Units utilizing cash generated from operating activities and other borrowed funds. During 2003, financing activities included borrowing \$180 million under two new collateralized mortgage loans, of which \$100 million was used to repay short-term debt and the Berg Group line of credit and \$80 million was used for the acquisition of the San Tomas Technology Park. For the year ended December 31, 2004, we paid dividends to our stockholders and made distributions to O.P. Unit holders totaling approximately \$101 million, compared to approximately \$100.1 million for the year ended December 31, 2003. Additionally, in 2004 we repaid \$3.3 million under our line of credit with the Berg Group.

COMPARISON OF THE YEAR ENDED DECEMBER 31, 2003 TO THE YEAR ENDED DECEMBER 31, 2002.

Net cash provided by operating activities for the year ended December 31, 2003 was approximately \$116.5 million, compared to approximately \$117.4 million for the prior year. The decrease in cash provided by operating activities resulted from adverse market conditions and loss of several tenants due to bankruptcy, cessation of operations, or tenant relocation resulting in increased vacancy rates that offset cash savings.

Net cash used in investing activities was approximately (\$110) million for the year ended December 31, 2003, compared to approximately (\$20.7) million for the prior year. Cash used in investing activities during 2003 related to financing the acquisition of the San Tomas Technology Park of \$110 million as well as new equipment and improvements of \$1.4 million.

Net cash used in financing activities was approximately (\$6.9) million for the year ended December 31, 2003, compared to (\$97.5) million for the year ended December 31, 2002. During 2003, we paid debt principal and made distributions to holders of our common stock and O.P. Units utilizing cash generated from operating activities and other borrowed funds. Financing activities in 2003 also consisted of a \$100 million collateralized mortgage loan from Northwestern Mutual Life Insurance Company, an \$80 million collateralized mortgage loan from Citicorp USA, Inc. and a \$40 million line of credit established with Cupertino National Bank in July 2002 of which

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

\$24.0 million had been drawn as of the year end. For the year ended December 31, 2003, we paid dividends to our stockholders and made distributions to the O.P. Unit holders totaling approximately \$100.1 million, compared to approximately \$99.7 million for the year ended December 31, 2002. Additionally, during 2003, we repaid \$61.5 million under our line of credit with the Berg Group and \$20 million under our uncollateralized loan with Citicorp USA, Inc.

CAPITAL EXPENDITURES

The properties require periodic investments of capital for tenant-related capital expenditures and for general capital improvements. For the years ended December 31, 2000 through December 31, 2004, the recurring tenant/building improvement costs and leasing commissions incurred with respect to new leases and lease renewals of the properties averaged approximately \$2.3 million annually. We will have approximately 501,000 rentable square feet under expiring leases in 2005. We expect that the average annual cost of recurring tenant/building improvements and leasing commissions, related to these properties, will be approximately \$2.0 million during 2005. We believe we will recover substantially all of these costs from the tenants under the new or renewed leases through contractual increases in rental rates. Until we actually sign the leases, however, we cannot assure you that this will occur. Capital expenditures may fluctuate in any given period subject to the nature, extent, and timing of improvements required to be made to the properties. Tenant/building improvements and leasing costs also may fluctuate in any given period year depending upon factors such as the property, the term of the lease, the type of lease and the overall market conditions. We expect to meet our long-term liquidity requirements for the funding of property acquisitions and other material non-recurring capital improvements through long-term secured and unsecured indebtedness and the issuance of additional equity securities by the Company, but cannot be assured that we will be able to meet our requirements on favorable terms. See "Policy with Respect to Certain Activities - Financing Policies."

- 43 -

FUNDS FROM OPERATIONS

FFO is a non-GAAP financial measurement used by real estate investment trusts to measure and compare operating performance. As defined by NAREIT, FFO represents net income (loss) before minority interest of O.P. Unit holders, computed in accordance with GAAP, including non-recurring events other than "extraordinary items" under GAAP and gains and losses from sales of depreciable operating properties, plus real estate related depreciation and amortization, excluding amortization of deferred financing costs and depreciation of non-real estate assets, and after adjustments for unconsolidated partnerships and joint ventures. Management considers FFO an appropriate measure of performance of an equity REIT because, along with cash flows from operating activities, financing activities and investing activities, it provides investors with an understanding of our ability to incur and service debt and make capital expenditures. With the emphasis on the disclosure of operating earnings per share, we will still continue to use FFO as a measure of the Company's performance. FFO should not be considered as an alternative for net income as a measure of profitability nor is it comparable to cash flows provided by operating activities determined in accordance with GAAP, nor is FFO necessarily indicative of funds available to meet our cash needs, including our need to make cash distributions to satisfy REIT requirements. For example, FFO is not adjusted for payments of debt principal required under our debt service obligations.

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

Our definition of FFO also assumes conversion at the beginning of the period of all convertible securities, including minority interests that might be exchanged for common stock. Our FFO does not represent the amount available for management's discretionary use; as such funds may be needed for capital replacement or expansion, debt service obligations or other commitments and uncertainties.

Furthermore, FFO is not comparable to similarly entitled items reported by other REITs that do not define FFO exactly as we do.

The FFO for the years ended December 31, 2004, 2003, 2002, 2001 and 2000 are as follows:

	For the Year Ended		
	2004	2003	2002
	(dollars in thousands)		
Net income to common stockholders	\$ 13,312	\$ 16,212	\$ 17,111
Add:			
Minority interests (1)	65,614	80,256	86,050
Depreciation and amortization of real estate (2)	24,394	22,850	21,377
Less:			
Gain on sales of joint venture assets or assets	-	(1,400)	(6,100)
FFO	\$103,320	\$117,918	\$118,444

- (1) The minority interest for third parties totaling \$486, \$581, \$587, \$650 and \$284 in 2004, 2003, 2002, 2001 and 2000, respectively, was deducted from total minority interest in calculating FFO.
- (2) Also includes our portion of depreciation and amortization of real estate from our unconsolidated joint venture totaling \$874 in both 2004 and 2003, and amortization of leasing commissions totaling \$1,644, \$1,203, \$3,020, \$694 and \$346 in 2004, 2003, 2002, 2001 and 2000, respectively. Amortization of leasing commissions is included in the property operating, maintenance and real estate taxes line item in the Company's consolidated statements of operations.

OVERVIEW OF DISTRIBUTION POLICY

We intend to make regular quarterly distributions to stockholders and O.P. Unit holders based on our funds available for distributions. Our ability to make such distributions will be affected by numerous factors including, most importantly, the receipt of distributions from the operating partnerships.

Funds available for distributions does not represent cash generated from operating activities and is not necessarily indicative of cash available to fund cash needs. The actual return that we will realize and the amount available for distributions to stockholders will be affected by a number of factors, including the revenues received from our properties, our operating expenses, debt service on borrowings, and planned and unanticipated capital expenditures.

We anticipate that cash available for distribution will exceed earnings and profits for federal income tax purposes, as the latter figure takes into

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

account non-cash expenses, such as depreciation and amortization, that we will incur. Distributions, other than capital gain distributions, by us to the extent of our current and accumulated earnings and profits for federal income tax purposes most likely will be taxable to U.S. stockholders as ordinary dividend income unless a stockholder is a tax-exempt entity. Distributions in excess of earnings and profits generally will be treated as a non-taxable reduction of the U.S.

- 44 -

stockholder's basis in the common stock to the extent of such basis, and thereafter as taxable gain. The percentage of such distributions in excess of earnings and profits, if any, may vary from period to period.

Distributions are determined by our Board of Directors and depend on actual cash available for distributions, our financial condition, capital requirements, the annual distribution requirements under the REIT provisions of the Code and such other factors as the Board of Directors deems relevant. For a discussion of the risk that we will not meet our distribution objectives, see Part I, Item 1, "Business - Risk Factors -- Stockholders are not assured of receiving cash distributions from us."

POLICIES WITH RESPECT TO CERTAIN ACTIVITIES

We have adopted policies with respect to investment, financing, conflicts of interest and other activities. These policies have been formulated by our Board of Directors, are set forth in our charter, bylaws, operating partnership agreements or agreements with the Berg Group, and generally may be amended or revised from time to time, subject to applicable agreement terms, at the discretion of the Board of Directors without a vote of the stockholders. Among other things, these policies provide that:

- so long as the Berg Group members and their affiliates, other than us and the operating partnerships, beneficially own, in the aggregate, at least 15% of the outstanding shares of common stock on a Fully Diluted basis, the approval of a majority of our directors, including Carl E. Berg or his designee as a director, and of the holders of a majority of the O.P. Units is required for us to take title to assets, other than temporarily in connection with an acquisition prior to contributing such assets to the operating partnerships, or to conduct business other than through the operating partnerships, or for us or the operating partnerships to engage in any business other than the ownership, construction, development and operation of real estate properties, or for certain fundamental corporate actions, including amendments to our charter, bylaws or any operating partnership agreement and any merger, consolidation or sale of all or substantially all of our assets or the assets of the operating partnerships;
- changes in certain policies with respect to conflicts of interest must be consistent with legal requirements;
- certain policies with respect to competition by and acquisitions from the Berg Group are imposed pursuant to provisions of the acquisition agreement that cannot be amended or waived without the approval of the Independent Directors Committee of our Board of Directors;
- we cannot take any action intended to terminate our qualification as a REIT without the approval of more than 75% of the entire Board of Directors; and

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

- we cannot undertake certain other specified transactions, including the issuance of debt securities, and borrowings in excess of specified limits, or the amendment of our charter and bylaws, without the approval of more than 75% of the entire Board of Directors.

INVESTMENT POLICIES

We expect to pursue our business and investment objectives principally through the direct ownership by the operating partnerships of our properties and future acquired properties. Development or investment activities are not limited to any specified percentage of our assets. We may also participate with other entities in property ownership, through joint ventures or other types of co-ownership. Equity investments may be subject to existing mortgage financing and other indebtedness that have priority over our equity interests.

While we will emphasize equity real estate investments, we may, in our discretion and subject to the percentage ownership limitations and gross income tests necessary for REIT qualification, invest in mortgage and other real estate interests, including securities of other real estate investment trusts. We have not previously invested in mortgages or securities of other real estate investment trusts, and we do not have any present intention to make such investments.

FINANCING POLICIES

To the extent that our Board of Directors determines to seek additional capital, we may raise such capital through additional equity offerings, debt financing or retention of cash flow, or through a combination of these sources, after consideration of provisions of the Code requiring the distribution by a REIT of a certain percentage of its taxable income and taking into account taxes that would be imposed on undistributed taxable income. It is our present intention that any additional borrowings will be made through the operating partnerships, although we may incur borrowings that would be re-loaned to the

- 45 -

operating partnerships. Borrowings may be unsecured or may be secured by any or all of our assets, the operating partnerships or any existing or new property, and may have full or limited recourse to all or any portion of our assets, the operating partnerships or any existing or new property.

We have adopted a policy of maintaining a consolidated ratio of debt to total market capitalization, which includes for this purpose the market value of all shares of common stock for which outstanding O.P. Units are exchangeable, of less than 50%. This ratio may not be exceeded without the approval of more than 75% of our entire Board of Directors. We also may determine to finance acquisitions through the exchange of properties or the issuance of additional O.P. Units in the operating partnerships, shares of common stock or other securities.

In the event that the Board of Directors determines to raise additional equity capital, it has the authority, without stockholder approval, to issue additional shares of common stock, preferred stock or other capital stock, including securities senior to the common stock, in any manner and on such terms and for such consideration it deems appropriate, including in exchange for property. In the event that we issue any shares of common stock or securities convertible into or exchangeable or exercisable for, shares of common stock, subject to limited exceptions, such as the issuance

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

of common stock pursuant to any stock incentive plan adopted by us or pursuant to limited partners' exercise of the exchange rights or the put rights, the limited partners will have the right to purchase common stock or such securities in order to maintain their respective percentage interests in us on a Fully Diluted basis. If the Board of Directors determines that we will raise additional equity capital to fund investments by the operating partnerships, we will contribute such funds to the operating partnerships as a contribution to capital and purchase of additional general partnership interest; however, holders of O.P. Units will have the right to participate in such funding on a pro rata basis. In the event that holders of O.P. Units sell their O.P. Units to us upon exercise of their put rights, we are authorized to raise the funds for such purchase by issuing additional shares of common stock. Alternatively, we may issue additional shares of common stock in exchange for the tendered O.P. Units.

Our Board of Directors also has the authority to cause the operating partnerships to issue additional O.P. Units in any manner and on such terms and for such consideration, as it deems appropriate, including in exchange for property. In the event that the operating partnerships issue new O.P. Units for cash, but not property, the limited partners holding O.P. Units in an operating partnership will have the right to purchase O.P. Units in order, and to the extent necessary, to maintain their respective percentage interests in that operating partnership. The new O.P. Units will be exchangeable for common stock pursuant to the exchange rights or may be tendered to us pursuant to the put rights.

DISPOSITION POLICIES

From time to time we may dispose of properties in our portfolio, subject to the required approvals as set forth below. The tax basis of the limited partners in the properties in the operating partnerships is substantially less than current fair market value. Accordingly, prior to the disposition of their O.P. Units, upon a disposition of any of the properties, a disproportionately large share of the gain for federal income tax purposes would be allocated to the limited partners. Consequently, it may be in the interests of the limited partners that we continue to hold the properties in order to defer such taxable gain. In light of this tax effect, the operating partnership agreements provide that, until December 29, 2008, or until the Berg Group members and their affiliates, other than us and the operating partnerships, beneficially own, in the aggregate, less than 15% of the outstanding shares of common stock on a Fully Diluted basis, if earlier, Carl E. Berg and Clyde J. Berg may prohibit the operating partnerships from disposing of properties which they designate in a taxable transaction. Mr. Kontrabecki has a similar right with respect to seven of the properties, which right will lapse before the end of the ten-year period if his beneficial ownership interest falls below 750,000 O.P. Units. The limited partners may seek to cause us to retain the properties even when such action may not be in the interests of some, or a majority, of our stockholders. The operating partnerships will be able to effect "tax-deferred," like-kind exchanges under Section 1031 of the Code, or in connection with other non-taxable transactions, such as a contribution of property to a new partnership, without obtaining the prior written consent of these individuals. The approval of a majority of our directors, including Carl E. Berg or his designee, will be required to sell all or substantially all of our assets. The consent of the holders of a majority of the O.P. Units will be required to effect a sale or sales of all, or substantially all, of the assets of any of the operating partnerships.

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS

We do not believe that recently issued accounting standards will materially impact our financial position, results of operations, or cash flows.

In December 2004, the FASB issued SFAS No. 123R, "Share-Based Payment," ("SFAS No. 123R") which addresses the accounting for employee and director stock options. Statement 123R requires that the cost of all employee and director stock options, as well as other equity-based compensation arrangements, be reflected in the financial statements based on the estimated fair value of the awards. SFAS No. 123R is an amendment to SFAS No. 123 and supersedes APB Opinion No. 25 ("APB No. 25"). SFAS No. 123R is applicable to any award that is settled or measured in stock, including stock options, restricted stock, stock appreciation rights, stock units, and employee stock purchase plans. SFAS No. 123R will be effective for public companies starting with the first interim period commencing after June 15, 2005. We will adopt the requirements of SFAS No. 123R in the third quarter of 2005. We expect that the adoption of this standard will reduce our net income and earnings per share; however, it will have no impact on cash flow. Although we have not yet determined whether the adoption of SFAS No. 123R will result in amounts that are similar to the current pro forma disclosures under SFAS No. 123, we are evaluating the requirements under SFAS No. 123R including the valuation methods and support for the assumptions that underlie the valuation of the awards and the transition methods (modified prospective transition method or the modified retrospective transition method).

In December 2004, the FASB issued SFAS No. 153, "Exchanges of Non-monetary Assets" ("SFAS No. 153"). SFAS No. 153 amends the guidance in APB Opinion No. 29, "Accounting for Non-monetary Transactions" to eliminate certain exceptions to the principle that exchanges of non-monetary assets be measured based on the fair value of the assets exchanged. SFAS No. 153 eliminates the exception for non-monetary exchanges of similar productive assets and replaces it with a general exception for exchanges of non-monetary assets that do not have commercial substance. This statement is effective for non-monetary asset exchanges in fiscal years beginning after June 15, 2005. The adoption of SFAS No. 153 is not expected to have an impact on our consolidated results of operations, financial position or cash flows.

- 47 -

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We do not generally hold market risk sensitive instruments for trading purposes. We use fixed and variable rate debt to finance our operations. Our exposure to market risk for changes in interest rates relates primarily to our current and future debt obligations. We are vulnerable to significant fluctuations of interest rates on our floating rate debt. We manage our market risk by monitoring interest rates where we try to recognize the unpredictability of the financial markets and seek to reduce potentially adverse effect on the results of our operations. This takes frequent evaluation of available lending rates and examination of opportunities to reduce interest expense through new sources of debt financing. Several factors affecting the interest rate risk include governmental monetary and tax policies, domestic and international economics and other factors that are beyond our control. The following table provides information about the principal cash flows, weighted average

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

interest rates, and expected maturity dates for debt outstanding as of December 31, 2004. The current terms of this debt are described in Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources." Average interest rates are based on implied LIBOR for the respective time period. Fair value approximates book value for fixed rate debt. Of the projected fair value of collateralized notes payable, approximately \$119.4 million and \$94.5 million represent the Prudential and Northwestern secured loans, respectively.

For variable rate debt, the table presents the assumption that the outstanding principal balance at December 31, 2004 will be paid upon maturity.

For fixed rate debt, the table presents the assumption that the outstanding principal balance at December 31, 2004 will be paid according to scheduled principal payments and that we will not prepay any of the outstanding principal balance.

	2005 ----	2006 ----	2007 ----	2008 ----	2009 ----
	(dollars in thousands)				
VARIABLE RATE DEBT:					
Secured and unsecured debt	\$2,580	\$109,898			
Weighted average interest rate	4.19%	4.19%			
FIXED RATE DEBT:					
Secured notes payable	\$5,704	\$6,042	\$6,350	\$116,674	\$4,382
Weighted average interest rate	6.23%	6.23%	6.23%	6.23%	6.23%

The variable rate debt represented 33.4% and 32.4% and the fixed rate debt represented 66.6% and 67.6% of all debt outstanding for the years ended December 31, 2004 and 2003, respectively. All of the debt is denominated in United States dollars. The weighted average interest rate for variable rate debt was approximately 4.19% and 3.13% for the years ended December 31, 2004 and 2003, respectively. The difference in spread was due to numerous increases in interest rates by the Federal Reserve Board during 2004. The weighted average interest rate for fixed rate debt was approximately 6.23% for the years ended December 31, 2004 and 2003. The difference in interest expense attributable to the average interest rate difference between 2003 and 2004 was \$1.1 million, which was a result of new debt obtained during 2003 and higher balances of our lines of credit in 2004. We anticipate interest rate increases from 2004 to 2005 for our variable rate debt.

The primary market risk we face is the risk of interest rate fluctuations. The Berg Group line of credit, the Cupertino National Bank line of credit and the Citicorp USA, Inc. loan, which are tied to a LIBOR based interest rate, were approximately \$112.5 million, or 33.4%, of the total \$337 million of debt as of December 31, 2004. As a result, we pay lower rates of interest in periods of decreasing interest rates and higher rates of interest in periods of increasing interest rates. At December 31, 2004, we had no interest rate caps or interest rate swap contracts.

The following discussion of market risk is based solely on a possible hypothetical change in future market conditions related to our variable rate debt. It includes "forward-looking statements" regarding market risk, but we are not forecasting the occurrence of these market changes. Based on the amount of variable debt outstanding as of December 31, 2004, a 1%

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

increase or decrease in interest rates on our \$112.5 million of floating rate debt would decrease or increase, respectively, annual earnings and cash flows by approximately \$1.1 million, as a result of the increased or decreased interest expense associated with the change in rate, and would not have an impact on the fair value of the floating rate debt. This amount is determined by considering the impact of hypothetical interest rates on our borrowing cost. Due to the uncertainty of fluctuations in interest rates and the specific actions that might be taken by us to mitigate any such fluctuations and their possible effects, the foregoing sensitivity analysis assumes no changes on our financial structure.

- 48 -

ITEM 8. CONSOLIDATED FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

MISSION WEST PROPERTIES, INC.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

Management Report on Internal Control over Financial Reporting
Report of Independent Registered Public Accounting Firm
Report of Independent Registered Public Accounting Firm on Internal Control over Financial Reporting
Consolidated Balance Sheets at December 31, 2004 and 2003
Consolidated Statements of Operations for the years ended December 31, 2004, 2003 and 2002
Consolidated Statements of Stockholders' Equity for the years ended December 31, 2004, 2003 and 2002
Consolidated Statements of Cash Flows for the years ended December 31, 2004, 2003 and 2002
Notes to the Consolidated Financial Statements
Supplemental Financial Information
Report of Independent Registered Public Accounting Firm
Schedule III: Real Estate and Accumulated Depreciation as of December 31, 2004
Schedule III: Real Estate and Accumulated Depreciation as of December 31, 2003

- 49 -

MANAGEMENT REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Management of Mission West Properties, Inc. is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934. Mission West Properties, Inc.'s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America. Internal control over financial reporting includes those written policies and procedures that:

- pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of Mission West Properties, Inc.;
- provide reasonable assurance that transactions are recorded as necessary to

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

- permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America;
- provide reasonable assurance that receipts and expenditures of Mission West Properties, Inc. are being made only in accordance with authorization of management and directors of Mission West Properties, Inc.; and
 - provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of assets that could have a material effect on the consolidated financial statements.

Internal control over financial reporting includes the controls themselves, monitoring and internal auditing practices and actions taken to correct deficiencies as identified.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect the possibility of human error, misstatements and the circumvention or overriding of controls. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of Mission West Properties, Inc.'s internal control over financial reporting as of December 31, 2004. Management based this assessment on the criteria for effective internal control over financial reporting established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Management's assessment included an evaluation of the design of Mission West Properties, Inc.'s internal control over financial reporting and testing of the operational effectiveness of its internal control over financial reporting. Management reviewed the results of its assessment with the Audit Committee of the Board of Directors.

Based on this assessment, management determined that as of December 31, 2004, Mission West Properties, Inc. maintained effective internal control over financial reporting.

BDO Seidman, LLP, independent registered public accounting firm, who audited and reported on the consolidated financial statements of Mission West Properties, Inc. included in this Annual Report on Form 10-K, has issued an attestation report on management's assessment of internal control over financial reporting.

- 50 -

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders
Mission West Properties, Inc.
Cupertino, California

We have audited the accompanying consolidated balance sheets of Mission West Properties, Inc. as of December 31, 2004 and 2003 and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2004. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Mission West Properties, Inc. at December 31, 2004 and 2003, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2004, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Mission West Properties, Inc.'s internal control over financial reporting as of December 31, 2004, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated January 28, 2005 expressed an unqualified opinion thereon.

\S\ BDO Seidman, LLP

San Francisco, California
January 28, 2005, except for Note 19
which is as of March 1, 2005

- 51 -

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Board of Directors and Stockholders
Mission West Properties, Inc.
Cupertino, California

We have audited management's assessment, included in the accompanying Management Report on Internal Control over Financial Reporting, that Mission West Properties, Inc. maintained effective internal control over financial reporting as of December 31, 2004, based on criteria established in Internal Control--Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that Mission West Properties, Inc. maintained effective internal control over financial reporting as of December 31, 2004, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, Mission West Properties, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2004, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets as of December 31, 2004 and 2003, and the related consolidated statements of operations, stockholders' equity and cash flows for each of the three years in the period ended December 31, 2004, and the financial statement schedule listed in the accompanying index, of Mission West Properties, Inc. and our reports dated January 28, 2005, expressed an unqualified opinion thereon.

\S\BDO Seidman, LLP

San Francisco, California
January 28, 2005

- 52 -

MISSION WEST PROPERTIES, INC.
CONSOLIDATED BALANCE SHEETS
(dollars in thousands, except share and per share data)

ASSETS

Dece

2004

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

Real estate assets:

Land	\$ 273,663
Buildings and improvements	770,757
Real estate related intangible assets	18,284

Total investments in properties	1,062,704
Less accumulated depreciation and amortization	(110,062)
Assets held for sale, net of accumulated depreciation of \$1,578 at 12/31/04	8,221

Net investments in properties	960,863
Cash and cash equivalents	1,519
Restricted cash	1,551
Deferred rent receivable, net of \$2,000 allowance at December 31, 2004 and 2003	18,511
Investment in unconsolidated joint venture	3,559
Other assets, net of accumulated amortization of \$5,667 and \$4,211 at December 31, 2004 and 2003, respectively	19,653

Total assets	\$1,005,656
	=====

LIABILITIES AND STOCKHOLDERS' EQUITY

Liabilities:

Line of credit (related parties)	\$ 9,560
Revolving line of credit	24,208
Mortgage notes payable	292,822
Mortgage note payable (related parties)	10,420
Interest payable	327
Security deposits	8,544
Deferred rental income	11,038
Liabilities related to assets held for sale	14
Dividend/distribution payable	16,718
Accounts payable and accrued expenses	6,704

Total liabilities	380,355

Commitments and contingencies

Minority interests	512,089
Stockholders' equity:	
Preferred stock, \$.001 par value, 20,000,000 shares authorized, none issued and outstanding	-
Common stock, \$.001 par value at December 31, 2004 and 2003, 200,000,000 shares authorized, 18,097,191 and 17,894,691 shares issued and outstanding at December 31, 2004 and 2003, respectively	18
Paid-in capital	134,539
Accumulated deficit	(21,345)

Total stockholders' equity	113,212

Total liabilities and stockholders' equity	\$1,005,656
	=====

See notes to consolidated financial statements

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

- 53 -

MISSION WEST PROPERTIES, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(dollars in thousands, except share and per share data)

	Year Ended D	
	2004	2003
Revenues:		
Rental revenue from real estate	\$119,523	\$129,181
Tenant reimbursements	14,946	18,400
Other income, including lease terminations, settlements and interest	6,914	4,100
	-----	-----
	141,383	152,681
Expenses:		
Property operating, maintenance and real estate taxes	20,540	21,600
Interest	17,581	16,400
Interest (related parties)	1,077	1,000
General and administrative	2,011	1,000
Depreciation and amortization of real estate	21,669	20,000
	-----	-----
	62,878	60,000
Income before equity in earnings of unconsolidated joint venture and minority interests	78,505	92,681
Equity in earnings of unconsolidated joint venture, including \$1,400 gain on sale of property acquired from related party in 2003	2,947	3,000
Minority interests	67,699	80,000
	-----	-----
Income from continuing operations	13,753	16,681
Discontinued operations, net of minority interests:		
Gain from disposal of discontinued operations	-	-
(Loss)/income attributable to discontinued operations	(441)	-
	-----	-----
(Loss)/income from discontinued operations	(441)	-
	-----	-----
Net income to common stockholders	\$13,312	\$16,681
Net income to minority interests	\$66,100	\$80,000
	=====	=====
Income per share from continuing operations:		
Basic	\$0.76	\$0.76
	=====	=====
Diluted	\$0.76	\$0.76
	=====	=====
(Loss)/income per share from discontinued operations:		
Basic	(\$0.02)	\$0.00
	=====	=====

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

Diluted	(\$0.02)	\$
=====		
Net income per share to common stockholders:		
Basic	\$0.74	\$
=====		
Diluted	\$0.74	\$
=====		
Weighted average shares of common stock (basic)	18,034,873	17,739
=====		
Weighted average shares of common stock (diluted)	18,076,498	17,802
=====		
Weighted average O.P. Units	86,444,773	86,476
=====		
Outstanding common stock	18,097,191	17,894
=====		
Outstanding O.P. Units	86,384,695	86,398
=====		

See notes to consolidated financial statements

- 54 -

MISSION WEST PROPERTIES, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(dollars in thousands, except share data)

	Shares of Common Stock Outstanding	Common Stock	Paid-in- Capital	Accu- De
	-----	-----	-----	-----
Balance, December 31, 2001	17,329,779	\$17	\$126,626	(\$18
Issuance of common stock upon option exercise	33,550		151	
Issuance of common stock upon O.P. Unit conversion	124,000		1,518	
Dividends declared				(16
Net income				17

Balance, December 31, 2002	17,487,329	17	128,295	(17
Issuance of common stock upon option exercise	150,362		1,014	
Issuance of common stock upon O.P. Unit conversion	257,000	1	2,827	
Dividends declared				(17
Net income				16

Balance, December 31, 2003	17,894,691	18	132,136	(18
Issuance of common stock upon option exercise	20,000		165	
Issuance of common stock upon O.P. Unit conversion	182,500		2,238	
Dividends declared				(15
Net income				13

Balance, December 31, 2004	18,097,191	\$18	\$134,539	(\$21
=====				

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

See notes to consolidated financial statements

- 55 -

MISSION WEST PROPERTIES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(dollars in thousands)

	Year Ended December	
	2004	2003
Cash flows from operating activities:		
Net income from continuing operations	\$13,753	\$16,001
Adjustments to reconcile net income to net cash provided by operating activities:		
(Loss)/income from discontinued operations	(441)	211
Minority interest	66,100	80,836
Depreciation and amortization of real estate and in-place leases	21,876	20,774
Amortization of above market lease	1,888	1,416
Gain on sale of assets	-	-
Equity in earnings of unconsolidated joint venture	(2,947)	(3,885)
Distributions from unconsolidated joint venture	1,673	2,000
Asset impairment charge	2,193	-
Other	-	-
Change in operating assets and liabilities, net of liabilities assumed:		
Deferred rent receivable	459	(1,969)
Other assets	2,195	(1,453)
Interest payable	(5)	(5)
Security deposits	(1,690)	(936)
Deferred rental income	(1,685)	2,847
Accounts payable and accrued expenses	1,701	656
Net cash provided by operating activities	105,070	116,493
Cash flows from investing activities:		
Improvements to real estate	(1,519)	(1,370)
Refundable option payment utilized for rent payments	-	-
Proceeds from sales of real estate	-	-
Purchase of real estate	-	(110,013)
Net proceeds from sale of TBI unconsolidated joint venture real estate	-	1,400
Net cash used in investing activities	(1,519)	(109,983)
Cash flows from financing activities:		
Principal payments on mortgage notes payable	(7,036)	(5,204)
Proceeds from mortgage loan payable	-	180,000
Principal payments on mortgage notes payable (related parties)	(342)	(316)
Net proceeds/(payments) under line of credit (related parties)	3,338	(61,471)

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

Proceeds from loan payable	-	-
Payment on loan payable	-	(20,000)
Proceeds from revolving line of credit	243	126
Restricted cash	(1,551)	-
Payment on line of credit	-	-
Financing costs	-	(863)
Net proceeds from exercise of stock options	165	1,014
Minority interest distributions	(83,686)	(83,194)
Dividends	(17,292)	(16,952)
	-----	-----
Net cash used in financing activities	(106,161)	(6,860)
	-----	-----
Net (decrease) in cash and cash equivalents	(2,610)	(350)
Cash and cash equivalents, beginning of year	4,129	4,479
	-----	-----
Cash and cash equivalents, end of year	\$1,519	\$4,129
	=====	=====

Refer to Note 14 for supplemental cash flow information.
See notes to consolidated financial statements

- 56 -

MISSION WEST PROPERTIES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands, except share and per share data)

1. ORGANIZATIONS AND FORMATION OF THE COMPANY

Mission West Properties, Inc. ("the Company") is a fully integrated, self-administered and self-managed real estate company that acquires and manages R&D/office properties in the portion of the San Francisco Bay Area commonly referred to as Silicon Valley. In July 1998, the Company purchased an approximate 12.11% of four existing limited partnerships (referred to collectively as the "operating partnerships") and obtained control of these partnerships by becoming the sole general partner in each one effective July 1, 1998 for financial accounting and reporting purposes. The Company purchased an approximate 12.11% interest in each of the operating partnerships. All limited partnership interests in the operating partnerships were converted into 59,479,633 operating partnership ("O.P.") Units, which represented a limited partnership ownership interest of approximately 87.89% of the operating partnerships. The operating partnerships are the vehicles through which the Company holds its real estate investments, makes real estate acquisitions, and generally conducts its business.

As of December 31, 2004, the Company owns a controlling general partnership interest of 17.16%, 21.63%, 16.14% and 12.38% in Mission West Properties, L.P., Mission West Properties, L.P. I, Mission West Properties, L.P. II and Mission West Properties, L.P. III, respectively, for a 17.26% general partnership interest in the operating partnerships, taken as a whole, on a consolidated weighted average basis.

The Company, through the operating partnerships, owns interests in 109 R&D properties at December 31, 2004, all of which are located in Silicon Valley.

BUSINESS SEGMENT INFORMATION

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

The Company's primary business is the ownership and management of R&D/office real estate with a geographic concentration in the Silicon Valley of the San Francisco Bay Area. Accordingly, the Company has concluded it currently has a single reportable segment for Statement of Financial Accounting Standards ("SFAS") No. 131 purposes.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

PRINCIPLES OF CONSOLIDATION AND FINANCIAL STATEMENT PRESENTATION:

The accompanying consolidated financial statements include the accounts of the Company and its controlled subsidiaries, the operating partnerships (the "Company"). All significant intercompany transactions have been eliminated in consolidation.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenue and expenses during the reporting periods. Accounting and disclosure decisions with respect to material transactions that are subject to significant management judgments or estimates include impairment of long lived assets, deferred rent receivables, and allocation of purchase price relating to property acquisitions and the related depreciable lives assigned. Actual results could differ from those estimates.

REAL ESTATE ASSETS AND RELATED INTANGIBLE ASSETS:

Real estate assets are stated at cost. Cost includes expenditures for improvements or replacements. Maintenance and repairs are charged to expense as incurred.

- 57 -

MISSION WEST PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED (Dollars in thousands, except share and per share data)

The purchase price allocation for property acquisitions is determined in accordance with the following principles under SFAS No. 141, "Business Combinations":

The fair value of the tangible assets of an acquired property, which includes land, building and building/tenant improvements, is determined by valuing the property as if it were vacant, and the "as-if-vacant" value is then allocated to land, building and tenant improvements based on management's determination of the relative fair values of these assets. Factors considered by management in performing these analyses include certain costs during the lease-up periods considering current market conditions and costs to execute similar leases. These costs include estimates of lost rental revenue, leasing commissions, and tenant improvements.

In allocating the fair value of the identified intangible assets of the acquired property, above-market in-place lease value is recorded based on the present value, using an interest rate which reflects the risks associated with the lease acquired, of the difference between (i) the contractual amounts to be paid pursuant to the in-place lease and (ii) management's estimate of fair market

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

lease rate for the corresponding in-place lease, measured over a period equal to the remaining non-cancelable lease term. The capitalized above-market lease value, included in real estate related intangible assets in the accompanying December 31, 2003 consolidated balance sheets, is amortized as an offset to rental revenue from real estate over the remaining non-cancelable lease term. The value of in-place leases, exclusive of the value of above-market in-place lease, is amortized to expense over the remaining non-cancelable periods of the respective leases. If a lease were to be terminated prior to its stated expiration, all unamortized amounts relating to that lease would be written off in the period that the lease is terminated.

DEPRECIATION AND AMORTIZATION:

Depreciation and amortization are computed using the straight-line method over estimated useful lives as follows:

Building shell and base building improvements of newly acquired properties-	Weighted average composite life of 40 years
Base building improvements made subsequent to initial property acquisition-	25 years
Tenant improvements and furniture and fixtures-	Lesser of life of asset, generally 5-10 years, or lease term
Above-market and in-place lease value-	Term of lease

IMPAIRMENT OF LONG-LIVED ASSETS:

The Company reviews real estate assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable in accordance with SFAS No. 144, "Accounting for the Impairment and Disposal of Long-Lived Assets." If the carrying amount of the asset, including any intangible assets associated with that asset, exceeds its estimated undiscounted net cash flow, before interest, the Company will recognize an impairment loss equal to the difference between its carrying amount and its estimated fair value. If impairment is recognized, the reduced carrying amount of the asset will be accounted for as its new cost. For a depreciable asset, the new cost will be depreciated over the asset's remaining useful life. Generally, fair values are estimated using discounted cash flow, replacement cost or market comparison analyses. The process of evaluating for impairment requires estimates as to future events and conditions, which are subject to varying market and economic factors, such as the vacancy rates, rental rates and operating costs for R&D facilities in the Silicon Valley area and related submarkets. Therefore, it is reasonably possible that a change in estimate resulting from judgments as to future events could occur which would affect the recorded amounts of the property. In connection with the January 2005 sale of an asset as more fully described in Note 19, an impairment loss of approximately (\$2,193) was recorded for the year ended December 31, 2004 and is classified in discontinued operations, net of minority interests. No impairment losses were recorded for the years ended December 31, 2003 and 2002.

DISCONTINUED OPERATIONS AND ASSETS HELD FOR SALE:

The Company has adopted SFAS No. 144, which addresses the financial accounting for the disposal of long lived assets. SFAS No. 144 requires that the results of operations and gains or losses on the sale of property sold subsequent to December 31, 2001 that were not classified as held for sale at December 31, 2001 as well as the results of operations from properties that were classified as held for sale subsequent to December 31, 2001 be presented in discontinued operations if both the following criteria are met: (a) the operation and cash

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

flows of the property have been (or will be) eliminated from the ongoing operations of the Company as a result of the disposal transaction; and (b) the Company will not have any significant involvement in the

- 58 -

MISSION WEST PROPERTIES, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED (Dollars in thousands, except share and per share data)

operations of the property after the disposal transaction. SFAS No. 144 also requires prior period results of operations for these properties to be restated and presented in discontinued operations in prior consolidated statements of operations.

An asset is generally classified as held for sale once management has committed to an action to sell the asset, the asset is available for immediate sale in its present condition (subject to terms that are usual and customary for sales of such assets), an active program to locate a buyer is initiated, the sale is probable, the asset is being actively marketed for sale at a price that is reasonable in relation to its current fair value and actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn. Upon the classification of a real estate asset as held for sale, the carrying value of the asset is reduced to the lower of its net book value or its fair value, less costs to sell the asset. Subsequent to the classification of assets as held for sale, no further depreciation expense is recorded. Real estate assets held for sale are stated separately on the accompanying consolidated balance sheets. Effective January 1, 2002 (through the implementation of SFAS No. 144), the operating results of real estate assets held for sale and sold are reported as discontinued operations in the accompanying consolidated statements of operations. The income/(loss) from discontinued operations includes the revenues and expenses, including depreciation, associated with the assets. This classification of operating results as discontinued operations applies retroactively for all periods presented for assets designated as held for sale subsequent to January 1, 2002. Additionally, gains and losses on assets designated as held for sale subsequent to January 1, 2002 are classified as part of discontinued operations.

CASH AND CASH EQUIVALENTS:

The Company considers highly liquid short-term investments with initial maturities of three months or less to be cash equivalents.

Cash and cash equivalents are primarily held in a single financial institution, and at times, such balances may be in excess of the Federal Deposit Insurance Corporation insurance limit.

OTHER ASSETS:

Included in other assets are costs associated with obtaining debt financing and commissions associated with new leases. Such debt financing costs are being amortized over the term of the associated debt, by a method that approximates the effective interest method and such lease commissions are amortized straight-line over the term of the related lease. If the lease is terminated prior to the end of the lease term, the Company charges any unamortized capitalized lease commission cost to expense in the period that the lease is terminated. Also included in other assets are obligation receivables from the Berg Group of approximately \$7,494 to construct a building at 245 Caspian Drive in Sunnyvale, California and \$2,529 in tenant improvements at 5345 Hellyer Avenue in San Jose, California (see Note 12).

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

MINORITY INTERESTS:

Minority interests represent the limited partnership interests in the operating partnerships.

REVENUE RECOGNITION:

Rental income is derived from operating leases and recognized on the straight-line method of accounting required by GAAP under which contractual rent payment increases are recognized evenly over the lease term. The difference between recognized rental income and rental cash receipts is recorded as Deferred Rent Receivable on the consolidated balance sheets. Certain lease agreements contain terms that provide for additional rents based on reimbursement of certain costs including property operating, maintenance and real estate taxes. These additional rents from tenant reimbursements are reflected on the accrual basis.

Rental revenue is affected if existing tenants terminate or amend their leases. The Company tries to identify tenants who may be likely to declare bankruptcy, cease operations or otherwise terminate leases prior to the end of the lease term. By anticipating these events in advance, the Company expects to take steps to minimize their impact on its reported results of operations through lease renegotiations and other appropriate measures. Reserves against Deferred Rent Receivable are estimated by management based on known financial conditions of tenants and management's estimate of net realizeability of such receivables based on existing or expected negotiations with tenants. The Company's judgments and estimations about tenants' capacity to continue to meet their lease obligations will affect the rental revenue recognized. To date, actual reductions in revenue as a result of early terminations and the tenants' inability to pay have been within management's

- 59 -

MISSION WEST PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED (Dollars in thousands, except share and per share data)

estimates. However, material differences may result in the amount and timing of our rental revenue for any period if we made different judgments or estimations.

Lease termination fees are recognized in other income when there is a signed termination letter agreement, all of the conditions of the agreement have been met, and the tenant is no longer occupying the property. These fees are paid by tenants who want to terminate their lease obligations before the end of the contractual term of the lease. There is no way of predicting or forecasting the timing or amounts of future lease termination fees.

The Company recognizes income from rent, tenant reimbursements and lease termination fees and other income once all of the following criteria are met in accordance with SEC Staff Accounting Bulletin 104 "Revenue Recognition":

- the agreement has been fully executed and delivered;
- services have been rendered;
- the amount is fixed and determinable; and
- the collectability is reasonably assured.

INCOME TAXES:

The Company has been taxed as a real estate investment trust ("REIT") under the Internal Revenue Code of 1986, as amended, (the "Code") commencing with the taxable year ended December 31, 1999. In order for the Company to qualify as a

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

REIT, it must distribute annually at least 90% of its REIT taxable income, as defined in the Code, to its stockholders and comply with certain other requirements. Accordingly, for the years ended December 31, 2004, 2003 and 2002, no provision for federal income taxes has been included in the accompanying consolidated financial statements.

For the years ended December 31, 2004 and 2003, the Company's total dividends paid or payable to the stockholders represent 98% of ordinary income and 2% return of capital for income tax purposes. For the year ended December 31, 2002, the Company's total dividends paid or payable to the stockholders represented 100% ordinary income for income tax purposes.

NET INCOME PER SHARE:

The computation of net income per share is based on the weighted average number of common shares outstanding during the period. Diluted earnings per share amounts are based upon the weighted average of common and common equivalent shares outstanding during the year.

ACCOUNTING FOR STOCK-BASED COMPENSATION:

SFAS No. 123, "Accounting for Stock-Based Compensation," encourages, but does not require companies to record compensation cost for stock-based employee compensation plans at fair value. The Company has chosen to continue to account for stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board Opinion ("APB") No. 25, "Accounting for Stock Issued to Employees" and related interpretations. Accordingly, compensation cost for stock options is measured as the excess, if any, of the quoted market price of the Company's stock at the date of the grant over the amount an employee must pay to acquire the stock.

- 60 -

MISSION WEST PROPERTIES, INC.
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED
 (Dollars in thousands, except share and per share data)

The following table illustrates the unaudited pro forma effect on consolidated net income available to common shareholders and consolidated earnings per share if the fair value method had been applied to all outstanding and unvested stock options for the last three years.

	Year Ended December	
	2004	2003
	(dollars in thousands, except p	
Historical net income to common stockholders	\$13,312	\$16,212
Add back compensation expense for stock options included in historical net income to common stockholders	-	-
Deduct compensation expense for stock options determined under fair value based method	(176)	(235)
Allocation of expense to minority interest	145	195
Pro forma net income to common stockholders	\$13,281	\$16,172

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

Earnings per share - basic:		
Historical net income to common stockholders	\$0.74	\$0.91
Pro forma net income to common stockholders	\$0.74	\$0.91
Earnings per share - diluted:		
Historical net income to common stockholders	\$0.74	\$0.91
Pro forma net income to common stockholders	\$0.73	\$0.91

There were no stock options granted in 2004, 2003 and 2002.

FAIR VALUE OF FINANCIAL INSTRUMENTS:

The Company's financial instruments include cash and cash equivalents, accounts receivable, accounts payable, and debt. Considerable judgment is required in interpreting market data to develop estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts that the Company could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts. Cash and cash equivalents, accounts receivable, and accounts payable are carried at amounts that approximate their fair values due to their short-term maturities. The carrying amounts of the Company's variable rate debt approximate fair value since the interest rates on these instruments are equivalent to rates currently offered to the Company. For fixed rate debt, the Company estimates fair value by using discounted cash flow analyses based on borrowing rates for similar kinds of borrowing arrangements. The fair value of the Company's fixed rate debt at December 31, 2004 was approximately \$244,309 as compared to its carrying value of \$224,532.

RECLASSIFICATIONS:

Certain amounts from prior year's consolidated financial statements have been reclassified to conform to the presentation of the current year's consolidated financial statements.

CONCENTRATION OF CREDIT RISK:

The Company's properties are not geographically diverse, and its tenants operate primarily in the information technology industry. Additionally, because the properties are leased to 79 tenants at December 31, 2004, default by any major tenant could significantly impact the results of the consolidated total. One tenant, Microsoft Corporation, accounted for approximately 18.1%, 16.3% and 15.7% of the Company's cash rental income for the years ended December 31, 2004, 2003 and 2002, respectively, with the next largest tenant accounting for 10.8%, 10.0% and 8.6%, respectively, of total cash rental income. Cash rental income from Microsoft Corporation was \$21,997, \$21,151 and \$20,338 for the years ended December 31, 2004, 2003 and 2002, respectively. Future minimum rents from this tenant are \$107,171. During 2004, eleven of the Company's tenants relocated or ceased operations.

- 61 -

MISSION WEST PROPERTIES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED
(Dollars in thousands, except share and per share data)

NEW ACCOUNTING PRONOUNCEMENTS:

In December 2004, the FASB issued SFAS No. 123R, "Share-Based Payment," which addresses the accounting for employee and director stock options. Statement 123R requires that the cost of all employee and director stock options, as well as

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

other equity-based compensation arrangements, be reflected in the financial statements based on the estimated fair value of the awards. SFAS No. 123R is an amendment to SFAS No. 123 and supersedes APB Opinion No. 25 ("APB 25"). SFAS No. 123R is applicable to any award that is settled or measured in stock, including stock options, restricted stock, stock appreciation rights, stock units, and employee stock purchase plans. SFAS No. 123R will be effective for public companies starting with the first interim period commencing after June 15, 2005. The Company will adopt the requirements of SFAS No. 123R in the third quarter of 2005. The Company expects that the adoption of this standard will reduce its net income and earnings per share; however, it will have no impact on cash flow. Although the Company has not yet determined whether the adoption of SFAS 123R will result in amounts that are similar to the current pro forma disclosures under SFAS No. 123, the Company is evaluating the requirements under SFAS No. 123R including the valuation methods and support for the assumptions that underlie the valuation of the awards and the transition methods (modified prospective transition method or the modified retrospective transition method).

In December 2004, the FASB issued SFAS No. 153, "Exchanges of Non-monetary Assets" ("SFAS No. 153"). SFAS No. 153 amends the guidance in APB Opinion No. 29, "Accounting for Non-monetary Transactions" to eliminate certain exceptions to the principle that exchanges of non-monetary assets be measured based on the fair value of the assets exchanged. SFAS No. 153 eliminates the exception for non-monetary exchanges of similar productive assets and replaces it with a general exception for exchanges of non-monetary assets that do not have commercial substance. This statement is effective for non-monetary asset exchanges in fiscal years beginning after June 15, 2005. The adoption of SFAS No. 153 is not expected to have an impact on the Company's consolidated results of operations, financial position or cash flows.

3. DEFERRED RENT ALLOWANCE

The following table represents activity in the deferred rent allowance for the years ended December 31, 2004, 2003 and 2002.

	Beginning Balance	Provision Against Revenues	Charge-off	Ending Balance
	-----			-----
	(dollars in thousands)			
Year ended December 31, 2002	\$600	\$4,736	\$3,336	\$2,000
Year ended December 31, 2003	\$2,000	\$2,552	\$2,552	\$2,000
Year ended December 31, 2004	\$2,000	\$1,313	\$1,313	\$2,000

4. STOCK TRANSACTIONS

As of December 31, 2004 and 2003, \$1,588 and \$1,471 remained outstanding under notes issued in connection with the Company's purchase of its general partnership interests in 1998 (the "demand notes"), respectively. The demand notes which accrue interest at 7.25%, along with the interest expense (interest income to the operating partnerships), are eliminated in consolidation and are not included in the corresponding line items within the consolidated financial statements. However, the interest income earned by the operating partnerships, which is interest expense to the Company, in connection with this debt, is included in the calculation of minority interest as reported on the consolidated statement of operations, thereby reducing the Company's net income by this same amount. The Company and the operating partnerships have agreed to extend the due date of the demand notes to September 30, 2006. At present, the Company's only means for repayment of this debt is through distributions received from the

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

operating partnerships in excess of the amount of dividends to be paid to the Company's stockholders.

The limited partners of the operating partnerships have the right to tender their O.P. Units to the Company for shares of common stock or, at the Company's election, for cash. Each of the limited partners of the operating partnerships (other than Carl E. Berg and Clyde J. Berg) has the annual right to exercise put rights and cause the operating partnerships to purchase a portion of the limited partner's O.P. Units at a purchase price based on the average market value of the common stock for the 10-trading day period immediately preceding the date of tender, generally limited to one-third of the aggregate number of O.P. Units owned by each limited partner. Upon the exercise of any such right by a limited partner, the Company will have the option to purchase the tendered O.P. Units with available cash, borrowed funds or the proceeds of an offering of newly issued shares of common stock. These put rights are available once a year. If the total purchase price of the O.P. Units tendered by

- 62 -

MISSION WEST PROPERTIES, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED (Dollars in thousands, except share and per share data)

all of the eligible limited partners in one year exceeds \$1 million, the Company or the operating partnerships will be entitled to reduce proportionately the number of O.P. Units to be acquired from each tendering limited partner so that the total purchase price does not exceed \$1 million.

During the year ended December 31, 2004, stock options at \$8.25 per share were exercised to purchase a total of 20,000 shares of the Company's common stock. Total proceeds to the Company were approximately \$165.

During the year ended December 31, 2003, stock options were exercised to purchase a total of 150,362 shares of the Company's common stock, consisting of 60,362 shares exercised at \$4.50 per share and 90,000 shares exercised at \$8.25 per share. Total proceeds to the Company were approximately \$1,014.

During the year ended December 31, 2002, stock options at \$4.50 per share were exercised to purchase a total of 33,550 shares of the Company's common stock. Total proceeds to the Company were approximately \$151.

In 2004 and 2003, 182,500 and 257,000 O.P. Units were exchanged for 182,500 and 257,000 shares of the Company's common stock, respectively, under the terms of the December 1998 Exchange Rights Agreement among the Company and all limited partners of the operating partnerships.

5. MINORITY INTEREST

Minority interest represents the separate private ownership of the operating partnerships, by the Berg Group and other non-affiliate interests. In total, these interests account for 82.74% and 82.98%, on a weighted average basis, of the ownership interests in the real estate operations of the Company as of December 31, 2004 and 2003, respectively. Minority interest in earnings has been calculated by taking the net income of the operating partnerships (on a stand-alone basis) multiplied by the respective minority interest ownership percentage.

The operating partnerships have ownership interests of 83.33%, 75% and 50% and act as the managing member in three separate joint ventures, which were established to hold properties. The operating partnerships control the joint

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

ventures, and accordingly, these joint ventures are consolidated in the Company's consolidated financial statements. The minority interest in the joint ventures is reflected as a component of minority interest of the operating partnerships. For the years ended December 31, 2004, 2003 and 2002, income associated with the minority interests held by the third parties of the three consolidated joint ventures was \$486, \$581 and \$587, respectively.

6. REAL ESTATE

BERG LAND HOLDINGS OPTION AGREEMENT

Under the terms of the Berg Land Holdings Option Agreement, the Company, through the operating partnerships, has the option to acquire any future R&D property developed by the Berg Group on land currently owned or optioned, or acquired for these purposes in the future, directly or indirectly, by Carl E. Berg or Clyde J. Berg. At present, there are approximately 90 acres of Silicon Valley land, including land under development, owned directly or under 50% joint venture entities by certain members of the Berg Group that are subject to the terms of the Berg Land Holdings Option Agreement. The owners of the future R&D property developments may obtain cash or, at their option, O.P. Units valued at the average closing price of the shares of common stock over the 30-trading-day period preceding the acquisition date. To date, the Company has completed 20 acquisitions under the Berg Land Holdings Option Agreement representing approximately 1,992,000 rentable square feet. Upon the Company's exercise of an option to purchase any of the future R&D property developments, the acquisition price will equal the sum of (a) the full construction cost of the building; plus (b) 10% of the full construction cost of the building; plus (c) interest at LIBOR (London Interbank Offer Rate) plus 1.65% on the amount of the full construction cost of the building for the period from the date funds were disbursed by the developer to the close of escrow; plus (d) the original acquisition cost of the parcel on which the improvements will be constructed, which range from \$8.50 to \$20.00 per square foot for land currently owned; plus (e) 10% per annum of the amount of the original acquisition cost of the parcel from the later of January 1, 1998 or the seller's acquisition date to the close of escrow; minus (f) the aggregate principal amount of all debt encumbering the acquired property, or a lesser amount as approved by the members of the Independent Directors committee of the Company's Board of Directors. Generally, the Company will not acquire any projects until they are fully completed and leased.

- 63 -

MISSION WEST PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED
(Dollars in thousands, except share and per share data)

No estimate can be given at this time as to the total cost to the Company to acquire future projects under the Berg Land Holdings Option Agreement, or the timing as to when the Company will acquire such projects. In addition to any projects currently under development, the Company has the right to acquire future developments by the Berg Group on up to 84 additional acres of land currently controlled by the Berg Group, which could support approximately 1.4 million square feet of new developments. Under the Berg Land Holdings Option Agreement, as long as the Berg Group ownership in the Company and the operating partnerships taken as a whole is at least 65%, the Company also has an option to purchase all land acquired, directly or indirectly, by Carl E. Berg or Clyde J. Berg in the future which has not been improved with completed buildings and which is zoned for, intended for or appropriate for R&D, office and/or industrial development or use in the states of California, Oregon, and Washington.

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

Although the Company has the right to acquire the new properties available to it under the terms of the Berg Land Holdings Option Agreement, there can be no assurance that the Company actually will consummate any intended transactions. Furthermore, the Company has not yet determined the means by which it would acquire and pay for any such properties or the impact of any of the acquisitions on its business, results of operations, financial condition or available cash for distribution.

Given the economic downturn in the Silicon Valley, the Company may not be able to maintain historical levels of growth from acquisitions of new developments in the future.

- 64 -

MISSION WEST PROPERTIES, INC.
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED
 (Dollars in thousands, except share and per share data)

7. DEBT

The following table sets forth certain information regarding debt outstanding as of December 31, 2004 and 2003.

Debt Description	Collateral Properties	Balance At December
		2004
		(dollars in thousands)
Line of Credit:		
Berg Group (related parties)	2033-2043 Samaritan Drive, San Jose, CA 2133 Samaritan Drive, San Jose, CA 2233-2243 Samaritan Drive, San Jose, CA 1310-1450 McCandless Drive, Milpitas, CA 1795-1845 McCandless Drive, Milpitas, CA	\$ 9,560
Cupertino National Bank(4)	Not Applicable	24,208
Mortgage Notes Payable (related parties):	5300-5350 Hellyer Avenue, San Jose, CA	10,420
Mortgage Notes Payable: (2)		-
Prudential Capital Group (3)		-
Washington Mutual	10460 Bubb Road, Cupertino, CA	154
Prudential Insurance Company of America (5)	10300 Bubb Road, Cupertino, CA 10500 North De Anza Blvd, Cupertino, CA 4050 Starboard Drive, Fremont, CA 45700 Northport Loop, Fremont, CA 45738 Northport Loop, Fremont, CA 450 National Ave, Mountain View, CA 6311 San Ignacio Avenue, San Jose, CA 6321 San Ignacio Avenue, San Jose, CA 6325 San Ignacio Avenue, San Jose, CA 6331 San Ignacio Avenue, San Jose, CA 6341 San Ignacio Avenue, San Jose, CA	119,441

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

6351 San Ignacio Avenue, San Jose, CA
 3236 Scott Blvd, Santa Clara, CA
 3560 Bassett Street, Santa Clara, CA
 3570 Bassett Street, Santa Clara, CA
 3580 Bassett Street, Santa Clara, CA
 1135 Kern Avenue, Sunnyvale, CA
 1212 Bordeaux Lane, Sunnyvale, CA
 1230 E. Arques, Sunnyvale, CA
 1250 E. Arques, Sunnyvale, CA
 1170 Morse Avenue, Sunnyvale, CA
 1600 Memorex Drive, Santa Clara, CA
 1688 Richard Avenue, Santa Clara, CA
 1700 Richard Avenue, Santa Clara, CA
 3540 Bassett Street, Santa Clara, CA
 3542 Bassett Street, Santa Clara, CA
 3544 Bassett Street, Santa Clara, CA
 3550 Bassett Street, Santa Clara, CA

Northwestern Mutual Life
 Insurance Company(6)

1750 Automation Parkway, San Jose, CA 94,517
 1756 Automation Parkway, San Jose, CA
 1762 Automation Parkway, San Jose, CA
 6320 San Ignacio Avenue, San Jose, CA
 6540-6541 Via Del Oro, San Jose, CA
 6385-6387 San Ignacio Avenue, San Jose, CA
 2251 Lawson Lane, Santa Clara, CA
 1325 McCandless Drive, Milpitas, CA
 1650-1690 McCandless Drive, Milpitas, CA
 20605-20705 Valley Green Dr., Cupertino, CA

Citicorp USA, Inc. (4)

2001 Walsh Avenue, Santa Clara, CA 78,710
 2880 Scott Boulevard, Santa Clara, CA
 2890 Scott Boulevard, Santa Clara, CA
 2770-2800 Scott Boulevard, Santa Clara, CA
 2220 Central Expressway, Santa Clara, CA
 2300 Central Expressway, Santa Clara, CA
 2330 Central Expressway, Santa Clara, CA
 20400 Mariani Avenue, Cupertino, CA

Mortgage Notes Payable

 292,822

Total

 \$337,010
 =====

- (1) The debt owed to the Berg Group under the line of credit carries a variable interest rate equal to LIBOR plus 1.30% and is payable in full in March 2006. The interest rate was 4.08% and 2.52% at December 31, 2004 and 2003, respectively.
- (2) Mortgage notes payable generally require monthly installments of interest and principal ranging from \$8 to \$827 over various terms extending through the year 2013. The weighted average interest rate of mortgage notes payable was 6.23% at December 31, 2004 and 2003.
- (3) The Prudential Capital Group mortgage loan was paid off in its entirety in October 2004. It was collateralized by one property located at 20400 Mariani Avenue in Cupertino, California. This property was added as additional collateral to the Citicorp USA, Inc. loan.

MISSION WEST PROPERTIES, INC.
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED
 (Dollars in thousands, except share and per share data)

- (4) Interest rate equal to LIBOR plus 2%. The interest rate for the Cupertino National Bank line of credit at December 31, 2004 and 2003 was 4.29% and 3.17%, respectively. The interest rate for the Citicorp USA, Inc. mortgage loan at December 31, 2004 and 2003 was 4.18% and 3.17%, respectively. The Cupertino National Bank line of credit and Citicorp USA, Inc. loan contain certain financial loan and reporting covenants as defined in the loan agreements. As of December 31, 2004, the Company was in compliance with these loan covenants.
- (5) The Prudential Insurance loan is payable in monthly installments of \$827, which includes principal (based upon a 30-year amortization) and interest. A limited partner, who is not a member of the Berg Group, has guaranteed approximately \$12,000 of this debt. Costs and fees incurred with obtaining this loan aggregated approximately \$900, which were deferred and amortized over the loan period.
- (6) The Northwestern loan is payable in monthly installments of \$696, which includes principal (based upon a 20-year amortization) and interest. Costs and fees incurred with obtaining this loan aggregated approximately \$675, which were deferred and amortized over the loan period.

Scheduled principal payments on debt as of December 31, 2004 are as follows:

	Fixed Rate Debt (Including Related Parties)	Variable Rate (Including Related Parties)
	-----	-----
December 31, 2005	\$ 5,704	\$ 2,580
December 31, 2006	6,042	109,898
December 31, 2007	6,350	-
December 31, 2008	116,674	-
December 31, 2009	4,382	-
Thereafter	85,380	-
	-----	-----
	\$224,532	\$112,478
	=====	=====

8. OPERATING PARTNERSHIP AND STOCKHOLDER DISTRIBUTIONS

Holders of the Company's common stock and O.P. Units are entitled to dividend distributions as determined and declared by the Company's Board of Directors. Under the Exchange Rights Agreement limited partners have the right to tender O.P. Units to the Company, and, at the Company's election, to receive common stock on a one-for-one basis at then-current market value, an equivalent amount of cash, or a combination of cash and common stock in exchange for the O.P. Units tendered, subject to the 9% overall ownership limit imposed on non-Berg Group stockholders under the Company's charter document, or the overall 20% Berg Group ownership limit, as the case may be. O.P. Unit holders are entitled to vote when their O.P. Units are converted to shares of the Company's common stock.

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

During 2004 the Company, as general partner of the operating partnerships, declared quarterly distributions aggregating \$0.88 per common share and O.P. Unit for total distributions of \$91,944, including \$16,717 payable in January 2005. During the fourth quarter of 2004, the Company's Board of Directors reduced the quarterly dividend distribution from \$0.24 per common share and O.P. Unit to \$0.16 per common share and O.P. Unit. Total distributions attributable to O.P. Units owned by various members of the Berg Group were \$69,075, which was treated as a draw on the Berg Group line of credit.

During 2003 the Company, as general partner of the operating partnerships, declared quarterly distributions aggregating \$0.96 per common share and O.P. Unit for total distributions of \$100,064, including \$25,031 payable in January 2004. Total distributions attributable to O.P. Units owned by various members of the Berg Group were \$75,230, which was treated as a draw on the Berg Group line of credit.

During 2002 the Company, as general partner of the operating partnerships, declared quarterly distributions aggregating \$0.96 per common share and O.P. Unit for total distributions of \$99,643, including \$24,951 payable in January 2003. Total distributions attributable to O.P. Units owned by various members of the Berg Group were \$75,076, which was treated as a draw on the Berg Group line of credit.

9. EQUITY-BASED COMPENSATION AND RETIREMENT INVESTMENT PLANS

The Company's 1997 Stock Option Plan was approved by the Company's shareholders on November 10, 1997. The 1997 Stock Option Plan was adopted so that the Company may attract and retain the high quality employees, consultants and directors necessary to build the Company's infrastructure and to provide ongoing incentives to the Company's employees in the form of options to purchase the Company's common stock by enabling them to participate in the Company's success.

- 66 -

MISSION WEST PROPERTIES, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED (Dollars in thousands, except share and per share data)

The 1997 Stock Option Plan provides for the granting to employees, including officers (whether or not they are directors) of "incentive stock options" within the meaning of Section 422 of the Code, and for the granting of non-statutory options to employees, consultants and directors of the Company. Options to purchase a maximum of 5,500,000 shares of common stock may be granted under the 1997 Stock Option Plan, subject to equitable adjustments to reflect certain corporate events.

No options were granted in 2004, 2003 and 2002.

The remaining contractual lives of unexercised options granted range from July 2005 to April 2009.

The following table shows the activity and detail for the 1997 Stock Option Plan.

1997 Stock Option Plan	Weighted Average Exercise Price Per Share
-----	-----

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

Balance, December 31, 2001	983,912	\$10.44
Options exercised	(33,550)	\$4.50

Balance, December 31, 2002	950,362	\$10.65
Options exercised	(150,362)	\$6.74
Options cancelled	(13,000)	\$13.00

Balance, December 31, 2003	787,000	\$11.36
Options exercised	(20,000)	\$8.25

Balance, December 31, 2004	767,000	\$11.44
	=====	

The following table summarizes information regarding options outstanding for the 1997 Stock Option Plan at December 31, 2004:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Options	Weighted Average Remaining Contractual Life in Years (1)	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
\$8.25	120,000	1.0	\$8.25	120,000	\$8.25
\$11.33	375,000	4.3	\$11.33	229,167	\$11.33
\$13.00	272,000	1.8	\$13.00	269,000	\$13.00
	-----			-----	
\$8.25 to \$13.00	767,000	2.9	\$11.44	618,167	\$11.44
	=====			=====	

(1) Expiration dates range from July 2005 to April 2009.

None of the options granted are contingent upon the attainment of performance goals or subject to other restrictions. As of December 31, 2004, outstanding options to purchase 618,167 shares of common stock were exercisable.

As of December 31, 2004, no additional shares were available for grant under the 1997 Stock Option Plan.

On November 24, 2004, the shareholders of Mission West Properties, Inc. approved the Company's 2004 Equity Incentive Plan ("2004 Plan"), which replaced the Company's 1997 Stock Option Plan ("1997 Plan"). The Company's board of directors approved the 2004 Plan in September 2004. No further options will be granted under the 1997 Plan.

- 67 -

MISSION WEST PROPERTIES, INC.
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED
 (Dollars in thousands, except share and per share data)

In replacing the 1997 Plan, the 2004 Plan:

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

- transferred up to 3,991,089 remaining shares available for issuance under the Company's 1997 Plan and terminated the 1997 Plan for any new grants;
- transferred up to an additional 767,000 shares subject to outstanding options under the 1997 Plan if they expire without being exercised;
- and includes the ability to grant restricted stock, restricted stock units, performance units, dividend equivalent rights, and other stock-based compensation, including O.P. Units of the Operating Partnerships, as well as incentive and non-statutory stock options.

Currently, the Company's 1997 Plan authorizes its board of directors to grant stock options to eligible employees and consultants and provides for the one-time automatic grant of options to non-employee directors upon joining the board of directors. The 2004 Plan will allow the Company to grant to employees and directors a wider range of awards than is permitted under the current stock option plan, including restricted stock, stock grants, restricted stock units, performance units, other stock-based compensation, including O.P. Units exchangeable for shares of common stock, and dividend equivalent rights, which will help the Company achieve its goal of attracting, retaining and motivating its personnel which is necessary to build the Company's infrastructure, achieve the Company's business goals and enhance stockholder value. No options or awards may be granted under the 2004 Plan after November 24, 2014.

Awards and options granted under the 2004 Plan may be granted to any employees, non-employee directors or consultants of the Company and any corporation or other entity affiliated with the Company, including the Operating Partnerships. Only employees of the Company or a corporate subsidiary may receive incentive stock options. Options can be granted to non-employee directors and consultants of the Company and to employees of the Company or a corporate subsidiary. No individual may receive in any one calendar year awards covering more than 500,000 of the total number of shares of stock.

The options generally are granted at the fair market value of the Company's common shares at the date of grant, vest over a four to six year period, are exercisable upon vesting and expire six to eight years from the date of grant. The exercise price for all incentive stock options under the 2004 Plan shall not be less than the fair market value of the underlying common shares at the time the option was granted.

Under the 2004 Plan, each non-employee member of the board of directors who became or becomes a member of the board of the directors after November 24, 2004, the date on which the Plan was approved by the Company's stockholders, will receive automatically a grant of an option to purchase 50,000 shares of common stock at an exercise price equal to 100% of the fair market value of the common stock at the date of grant of such option. Such options become exercisable cumulatively with respect to 1/48th of the underlying shares on the first day of each month following the date of grant. Generally, the options must be exercised while the optionee remains a director. In addition, the board of directors may authorize annual option grants or awards to non-employee directors in the board's discretion as long as the number of shares or equivalent number of underlying shares of common stock in the case of certain awards, does not exceed 50,000 per year. A disinterested majority of the board also may authorize additional options and awards to a director serving as a Committee chair or providing other extraordinary service to the Board. The 2004 Plan further provides that upon an acquisition of the Company in which more than 50% of the total voting power of the Company's outstanding securities is transferred to the acquirer or acquiring parties, options and awards held by non-employee directors will vest in full and become exercisable prior to their expiration.

The board of directors may terminate the 2004 Plan at any earlier time or make modifications of the 2004 Plan as it deems advisable. Awards and options granted at any time during the term of the 2004 Plan will not expire solely because of the termination of the 2004 Plan, and no amendment or modification of the 2004

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

Plan shall affect the terms of any outstanding award unless the board expressly provides otherwise. Termination or amendment of the 2004 Plan may not adversely affect the rights of the recipient of an award without his or her consent. The Compensation Committee of the Board of Directors may amend the terms of any option or award previously granted, but such amendment may not impair the rights of the recipient without his or her consent.

A total of 3,991,089 shares of common stock are reserved for issuance under the 2004 Plan. At no time may the number of shares issued pursuant to or subject to outstanding awards granted under the 2004 Plan exceed this number, subject to the provisions for increase and adjustment set forth in the 2004 Plan. If any option or award expires, terminates or is cancelled without being exercised in full, or any other award is forfeited, the shares forfeited or not purchased will be available for future grant of awards. As of December 31, 2004, no options or awards were granted under the 2004 Plan.

- 68 -

MISSION WEST PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED (Dollars in thousands, except share and per share data)

The Company has adopted an employee investment plan (the "Plan"), under Section 401(k) of the Internal Revenue Code. Employees who are at least 21 years old and who have completed six months of eligibility service may become participants in the Plan. Each participant may make contributions to the Plan through salary deferrals in amounts of at least 1% to a maximum of 15% of the participant's compensation, subject to certain limitations imposed by the Internal Revenue Code. The Company contributes an amount up to 15% of the participant's compensation, based upon management's discretion. A participant's contribution to the Plan is 100% vested and non-forfeitable. A participant will become vested in 100% of the Company's contributions after two years of eligible service. For the years ended December 31, 2004, 2003 and 2002, the Company recognized \$92, \$92 and \$95 of expense for employer contributions made in connection with this plan, respectively.

10. NET INCOME PER SHARE

Basic net income per share is computed by dividing net income by the weighted-average number of common shares outstanding for the period. Diluted net income per share is computed by dividing net income by the sum of weighted-average number of common shares outstanding for the period plus the assumed exercise of all dilutive securities.

The computation for weighted average shares is detailed below:

	Year Ended December 31, 2004	Year End December 31
	-----	-----
Weighted average shares outstanding (basic)	18,034,873	17,739,
Incremental shares from assumed option exercise	41,625	63,
	-----	-----
Weighted average shares outstanding (diluted)	18,076,498	17,802,
	=====	=====

Outstanding options to purchase 272,000, 647,000 and 285,000 shares in 2004,

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

2003 and 2002, respectively, were excluded from the computation of diluted net income per share under the treasury stock method because the option exercise price was greater than the weighted average exercise price of the Company's common stock during the respective periods. The outstanding O.P. Units have been excluded from the diluted net income per share calculation as there would be no effect on the diluted net income per share since the minority interests' share of income would also be added back to net income. O.P. Units outstanding at December 31, 2004 and 2003 were 86,384,695 and 86,398,064, respectively.

11. OTHER INCOME

Other income, including interest, was approximately \$6,914, \$4,527 and \$4,248 for the years ended December 31, 2004, 2003 and 2002, respectively. For the year ended December 31, 2004, termination fees and prior tenant bankruptcy settlements accounted for approximately \$4,250 and \$1,199, respectively, of other income. For the year ended December 31, 2003, prior tenant bankruptcy settlements accounted for approximately \$2,231 of other income. For the year ended December 31, 2002, termination fees accounted for approximately \$2,529 of other income.

12. RELATED PARTY TRANSACTIONS

As of December 31, 2004 and 2003, the Berg Group owned 77,577,528 and 78,364,716 O.P. Units, respectively, of the total 86,384,695 and 86,398,064 O.P. Units issued and outstanding, respectively. The Berg Group's interest in the Company represents 74.2% and 75.1% of the Company as of December 31, 2004 and 2003, respectively, assuming conversion of the O.P. Units into common shares of the Company.

The Company periodically acquires unleased properties, which include land, the building shell and base building improvements, from the Berg Group under the Berg Group Land Holdings Options Agreement. These acquisitions from the Berg Group are made for properties where the Company has previously identified a tenant, and in conjunction with the acquisition, the Company executes a lease agreement with the tenant. In many of the acquisitions from the Berg Group, lease commissions relating to these leasing activities conducted by the Company are paid by the Berg Group and reimbursed by the Company in connection with the acquisition. These lease commissions are recorded separately in other assets on the Company's consolidated balance sheets.

The Company did not acquire any properties from the Berg Group in 2004.

During 2003 the Company acquired one R&D property in San Jose and a 50% interest in a joint venture from the Berg Group. These acquisitions added approximately 129,000 square feet of rentable space and were acquired under the Berg Land

- 69 -

MISSION WEST PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED
(Dollars in thousands, except share and per share data)

Holdings Option Agreement. The total gross acquisition price was approximately \$12,953. The Company financed these acquisitions by borrowing \$9,000 under its line of credit from the Berg Group and issuing 350,163 O.P. Units to various members of the Berg Group.

As of December 31, 2004 and 2003, debt in the amount of \$9,560 and \$6,320, respectively, was due the Berg Group under the line of credit. This amount includes \$9,000 of debt assumed in connection with an acquisition of a property from the Berg Group in 2003. Additionally, in 2004 and 2003, the operating partnerships declared distributions of \$0.88 and \$0.96 per O.P. Unit,

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

respectively. Distributions paid to various members of the Berg Group were \$69,075 and \$75,224 in 2004 and 2003, respectively. Interest expense incurred in connection with the Berg Group line of credit was \$266, \$227 and \$2,562 for the years ended December 31, 2004, 2003 and 2002, respectively.

As of December 31, 2004 and 2003, debt in the amount of \$10,420 and \$10,762, respectively, was due the Berg Group under a mortgage note established May 15, 2000 in connection with the acquisition of a 50% interest in Hellyer Avenue Limited Partnership, the obligor under the mortgage note. The mortgage note bears interest at 7.65%, and is due in ten years with principal payments amortized over 20 years. Interest expense incurred in connection with the Berg Group mortgage note was \$811, \$837 and \$860 for the years ended December 31, 2004, 2003 and 2002, respectively.

TRANSFER OF INTEREST TO BERG GROUP IN CONSOLIDATED JOINT VENTURE:

In July 2000, the Hellyer Avenue Limited Partnership ("Hellyer LP") was formally organized as a California limited partnership between Mission West Properties, L.P. ("MWP"), of which the Company as the managing general partner, and Republic Properties Group ("RPC"), an unaffiliated third party, as general partner and limited partners. MWP was designated as the managing general partner of Hellyer LP. For a 50% ownership interest in Hellyer LP, RPC agreed to cause Stellex Microwave Systems, Inc. ("Stellex") to provide a 15-year lease on approximately 160,000 square foot R&D buildings to be constructed by Berg & Berg Enterprises, Inc. ("BBE") on land owned by another Berg Group member.

As part of the transaction, MWP acquired the underlying land pursuant to the Berg Land Holdings Option Agreement for a price of \$5.7 million by issuing 659,223 OP units to the Berg Group entity that owned the property. Further, under the terms of the Hellyer LP partnership agreement MWP then contributed the land to the partnership at an agreed value of \$9.6 million, which amount was to be amortized and paid to MWP in the form of income and cash flow preferences. The transaction was reviewed and approved by the Independent Directors Committee of the Company's Board of Directors.

In connection with the transaction, BBE built and paid for all improvements on the land. The total cost of the R&D building, exclusive of specified tenant improvements obligations, was approximately \$11.4 million. Hellyer LP issued a note for the amount of those construction costs to BBE, which note was secured by the buildings.

Because RPC's interest in Hellyer LP was attributable solely to its commitment to obtain Stellex as a tenant for the property, the partnership agreement provided that if a payment default occurred within the first five years of the Stellex lease, RPC would lose 100% of its interest in the partnership, and if a payment default occurred during the second five year period under the lease, RPC would lose 50% of its interest in Hellyer LP.

Pursuant to RPC's commitment to Hellyer LP Stellex executed a lease agreement obligating Stellex, among other things, to pay monthly rent starting at \$1.60 per square foot on a triple net basis for 15 years and to reimburse BBE for the tenant improvement obligations, which ultimately totaled approximately \$10.5 million.

Under the lease terms, Stellex was obligated to reimburse BBE in full for the tenant improvement costs no later than August 25, 2000. Several days before the due date, representatives of Stellex met with representatives of MWP and informed them that Stellex could not pay the balance due BBE. Stellex requested MWP immediately to draw down the letter of credit as a result of default on the tenant improvement payment required under the lease.

On September 1, 2000, MWP, as the general partner of Hellyer LP, ceased all

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

allocations of income and cash flow to RPC and exercised the right under the partnership agreement to cancel RPC's entire interest in the partnership. Following discussions with and approval by the Independent Directors Committee, the Company authorized the transfer of RPC's interest in Hellyer LP to BBE. Under the Berg Land Holdings Option Agreement and the Acquisition Agreement dated as of May 14, 1998, the Independent Directors Committee of the Board of Directors had the right, but not the obligation, to reacquire on behalf of the Company the property interest and the related distributions related to the property interest at any time. The transfer was effective as of September 1, 2000.

- 70 -

MISSION WEST PROPERTIES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED
(Dollars in thousands, except share and per share data)

In January 2002, Stellex was acquired through its bankruptcy proceeding by a division of Tyco Corporation. In connection with the acquisition of Stellex, the purchaser assumed the lease with Hellyer LP, agreed to comply with all terms of lease and reimbursed BBE for the tenant improvements, as required under the lease agreement and the Bankruptcy Court order.

Since the inception of Hellyer LP, the Company has accounted for the properties owned by the partnership on a consolidated basis, with reductions for the minority interest held by the minority partner (first RPC and then BBE). In each period, the Company has accrued amounts payable by Hellyer LP to the minority interest partner, including BBE prior to payment. BBE's share of earnings allocated to its 50% minority interest was \$682, \$400 and \$303 in 2004, 2003 and 2002, respectively. As of December 31, 2004, accumulated cash flow distributions from Hellyer LP totaling approximately \$2.2 million were accrued and distributed to BBE. If the Company's litigation with RPC is ultimately decided in RPC's favor, the Company anticipates that BBE may be required to return RPC's former interest in Hellyer LP and all prior distributions to RPC. As a result of this uncertainty, in October 2003, the Company recorded such distributions as an account receivable from BBE, which is included in other assets, with an offsetting account payable to BBE.

If the litigation is ultimately decided in favor of the Company, the Independent Directors Committee of the Board of Directors has the right, but not the obligation, to acquire on behalf of the Company the former RPC interest and related distributions from BBE under the terms of the Berg Land Holdings Option Agreement and the Acquisition Agreement between the Company and the Berg Group.

ACQUISITION OF CARL E. BERG'S INTEREST IN UNCONSOLIDATED JOINT VENTURE:

In July 1999, an unrelated party, TBI, advised Carl E. Berg that TBI had an option to purchase approximately 78.89 acres of unimproved land zoned for R&D development in Morgan Hill at \$2.50 per square foot that would expire in approximately six months. TBI offered Mr. Berg a 50% interest in the development of this land if Mr. Berg provided 100% financing for the land at 0% interest for three years. Mr. Berg advised TBI of his obligation to offer all R&D development opportunities on the West Coast to the Company and further advised TBI that the Company's Independent Directors Committee must approve the acquisition of any properties and that the Company's policy was only to acquire properties that are leased pursuant to the Berg Land Holdings Option Agreement. The development joint venture between TBI and the Berg Group proceeded on that basis. Building construction was financed through loans facilitated by the Berg Group. In early 2003, TBI formed TBI-MSW, a new limited partnership, to own all the leased buildings. The Berg Group offered its 50% non-controlling limited partnership interest in TBI-MSW to the Company at cost plus an annual interest rate of 7% on the funds advanced by the Berg Group which amounted to \$1.8 million. The

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

Independent Directors Committee and the Berg Group agreed to use a 7% interest rate instead of the rate and fees specified in the Berg Land Holdings Option Agreement because the transaction differed from the standard build-to-suit development specified under that agreement. TBI-MSW owned four fully leased buildings totaling approximately 593,000 rentable square feet. The buildings were subject to mortgage loans totaling \$53.6 million. The Independent Directors Committee approved the Company's acquisition of the Berg Group's 50% interest in the joint venture, effective January 1, 2003. The development joint venture between the Berg Group and TBI retained two vacant shell R&D buildings and five unimproved lots. In April 2003, Comcast, Inc. offered to purchase one of the vacant buildings and two acres of adjoining land from the development joint venture for net proceeds of \$2.8 million, after debt repayment. Prior to sale of the property, TBI-MSW acquired this property at no cost under the terms of the Berg Land Holdings Option Agreement, and the Company received a net distribution of \$1.4 million from the sale. The transaction was approved by the Independent Directors Committee. The Berg Group continues to own a 50% interest in the remaining vacant building and five unimproved lots.

BERG CONTROLLED ENTITIES HAVE FINANCIAL INTERESTS IN CERTAIN TENANTS THAT LEASE SPACE FROM THE COMPANY:

During December 31, 2004, 2003 and 2002, Carl E. Berg or entities controlled by Mr. Berg have financial interests in several companies that lease space from the operating partnerships, which include three companies where Mr. Berg has a greater than 10% ownership interest. These related tenants occupy approximately 48,000 square feet and contributed \$866, \$904 and \$748 in rental revenue in 2004, 2003 and 2002, respectively. Under the Company's Charter, bylaws and agreements with the Berg Group, the individual members of the Berg Group are prohibited from acquiring shares of the Company's common stock if such acquisition would result in their beneficial ownership percentage of the Company's common stock causing the Company to violate any REIT qualification requirement.

- 71 -

MISSION WEST PROPERTIES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED
(Dollars in thousands, except share and per share data)

BERG COMMITMENT TO COMPLETE FUTURE IMPROVEMENTS AND BUILDING IN CONNECTION WITH CERTAIN ACQUISITIONS FROM THE BERG GROUP UNDER THE BERG LAND HOLDINGS OPTION AGREEMENT:

The Berg Group has an approximately \$2.5 million commitment to complete certain tenant improvements in connection with the Company's 2002 acquisition of 5345 Hellyer Avenue in San Jose, California. The Company recorded this portion of its purchase consideration paid to the Berg Group as an Other Asset on its Consolidated Balance Sheets. The Berg Group plans to satisfy this commitment to complete certain tenant improvements when requested by the Company following the approval of the Independent Directors Committee.

The Berg Group has an approximately \$7.5 million commitment to complete an approximately 75,000 to 90,000 square foot building in connection with the Company's 2001 acquisition of 245 Caspian Drive in Sunnyvale, California which is comprised of approximately three acres of unimproved land. The Company recorded this portion of its purchase consideration paid to the Berg Group as an Other Asset on its Consolidated Balance Sheets. The Berg Group plans to satisfy this commitment to construct a building when requested by the Company following the approval of the Independent Directors Committee.

LEASING AND OVERHEAD REIMBURSEMENTS PROVIDED BY BERG CONTROLLED ENTITY:

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

The Company currently leases office space owned by Berg & Berg Enterprises, Inc., an affiliate of Carl E. Berg and Clyde J. Berg. Rental amount and overhead reimbursements paid to Berg & Berg Enterprises, Inc. were \$90 for each year ended December 31, 2004, 2003 and 2002.

13. FUTURE MINIMUM RENTS

The Company, through the operating partnerships, owns interests in 109 R&D properties that are leased to tenants under net operating leases with initial terms extending to the year 2015, and are typically subject to fixed increases. Generally, the leases grant tenants renewal options. Future minimum rentals under non-cancelable operating leases, excluding tenant reimbursements of expenses are as follows:

Year	Minimum Rent
----- (dollars in thousands)	
2005	\$102,084
2006	95,389
2007	77,429
2008	62,838
2009	54,297
Thereafter	134,218

Total	\$526,255
=====	

14. SUPPLEMENTAL CASH FLOW INFORMATION

Cash paid for interest was \$18,363, \$17,146 and \$12,752 for the years ended December 31, 2004, 2003 and 2002, respectively.

In connection with property acquisitions, the Company assumed \$9,000 and \$18,000 of related party debt due the Berg Group, assumed other liabilities of \$783 and \$387 and issued 350,163 and 835,491 O.P. Units for a total acquisition value of \$12,953 and \$30,953 for the years ended December 31, 2003 and 2002, respectively. The Company did not make any property acquisitions in 2004.

Amounts of \$75,326, \$75,224 and \$75,281 were due the Berg Group for distributions declared to O.P. Unit holders during the years ended December 31, 2004, 2003 and 2002, respectively, and were treated as draws under the Berg Group line of credit.

15. COMMITMENTS AND CONTINGENCIES

The Company and the operating partnerships, from time to time, are parties to litigation arising out of the normal course of business. Management is not aware of any litigation against the Company and believes the ultimate outcome would not have a material adverse effect on the cash flows, consolidated financial position or results of operations of the Company.

- 72 -

MISSION WEST PROPERTIES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED
(Dollars in thousands, except share and per share data)

Edgar Filing: MISSION WEST PROPERTIES INC - Form 10-K/A

REPUBLIC PROPERTIES CORPORATION (RPC) V. MISSION WEST PROPERTIES, L.P., IN THE CIRCUIT COURT OF MARYLAND FOR BALTIMORE CITY CASE NO. 24-C-00-005675. RPC is a former partner with Mission West Properties, L.P. in the Hellyer Avenue Limited Partnership. In April 2004, the Circuit Court for Baltimore City, Maryland issued a Memorandum Opinion in the case. Following a review of the Maryland Court's decision, our legal counsel advised us to request a review of the decision by the Maryland Appeals Court. A Maryland Appeals Court or any further court decision that may not rule in favor of Mission West Properties L.P. in this matter will not have a material adverse affect on our financial statements. In July 2004 RPC attached the Company's bank account for approximately \$1.1 million. Following a July 2004 hearing in Superior Court of the State of California for the County of Santa Clara the parties agreed that the Company will post a \$1.5 million bond and RPC will remove the attachment from the Company's bank account until final resolution of the appeal in Maryland. In February 2001 the Company filed a suit against RPC in Superior Court of the State of California for the County of Santa Clara Case No. CV 796249 which has been stayed pending resolution of the Maryland case. See Note 19.

MISSION WEST PROPERTIES, L.P. V. PREMISYS COMMUNICATIONS, INC. AND ZHONG TECHNOLOGIES, INC. IN THE SUPERIOR COURT OF THE STATE OF CALIFORNIA FOR THE COUNTY OF ALAMEDA CASE NO. HG03118906. This was a breach of lease case which the Company received a \$1.1 million settlement for in April 2004.

CRAIG R. JALBERT LIQUIDATING CEO, AS REPRESENTATIVE OF THE ESTATE OF THE CONSOLIDATED DEBTORS FOR ACT MANUFACTURING, INC. V. MISSION WEST PROPERTIES, L.P. IN UNITED STATES BANKRUPTCY COURT DISTRICT OF MASSACHUSETTS CASE NO. 01-47641 (JBR). The Company is vigorously opposing this claim which asserts that certain payments made in the ordinary course of business within 90 days of the ACT bankruptcy filing were alleged preference payments. The amount of the claim is \$482. In December 2004, the Company settled this matter and received a final payment of \$276 which was recorded as other income in the consolidated statements of operations.

THE GLOBAL CROSSING ESTATE REPRESENTATIVE, FOR ITSELF AND THE LIQUIDATING TRUSTEE OF THE GLOBAL CROSSING LIQUIDATING TRUST V. MISSION WEST PROPERTIES, L.P. IN UNITED STATES BANKRUPTCY COURT SOUTHERN DISTRICT OF NEW YORK CASE NO. 02-40188 (REG). The Company is vigorously opposing this claim which asserts that certain payments made in the ordinary course of business within 90 days of the Global Crossing bankruptcy filing were alleged preference payments. The amount of the claim is \$815. In addition, the Global debtors and the Creditor's Committee filed an objection to the unsecured claim filed by Mission West Properties in the Global cases for \$16,711. See Note 19.

GUARANTEES

Under its certificate of incorporation and bylaws, the Company has agreed to indemnify its officers and directors for certain events or occurrences arising as a result of the officer or director's serving in such capacity. The maximum potential amount of future payments the Company could be required to make under these indemnification agreements is unlimited. The Company believes the estimat