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BNP RESIDENTIAL PROPERTIES INC

Form 10-Q

August 02, 2006

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2006  
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OR

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

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

Commission file number: 1-9496

BNP RESIDENTIAL PROPERTIES, INC.  
(Exact name of Registrant as specified in its charter)

Maryland  
State or other jurisdiction of  
incorporation or organization  
56-1574675  
(I.R.S. Employer  
Identification No.)

301 S. College Street, Suite 3850, Charlotte, NC 28202-6024  
(Address of principal executive offices) (Zip Code)

704/944-0100  
(Registrant's telephone number)

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. X Yes \_ No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer: Large accelerated filer \_ Accelerated filer X Non-accelerated filer \_

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of July 31, 2006 (the latest practicable date).

Common Stock, \$.01 par value	10,428,754
-----	-----
(Class)	(Number of shares)

TABLE OF CONTENTS

Item No.		Page No.
	PART I - Financial Information (Unaudited)	
1	Financial Statements	3
2	Management's Discussion and Analysis of Financial Condition and Results of Operations	13
3	Quantitative and Qualitative Disclosures About Market Risk	30
4	Controls and Procedures	31
	PART II - Other Information	
4	Submission of Matters to a Vote of Security Holders	31
5	Other Information	32
6	Exhibits	32
	Signatures	33

PART I - Financial Information

Item 1. Financial Statements.

BNP RESIDENTIAL PROPERTIES, INC.

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Consolidated Balance Sheets

(all amounts in thousands except share amounts)

	June 30 2006	Decem 2
	----- (Unaudited)	
Assets		
Real estate investments at cost:		
Apartment properties	\$ 574,754	
Restaurant properties	37,405	
	-----	
	612,159	
Less accumulated depreciation	(96,868)	
	-----	
	515,291	
Cash and cash equivalents	3,536	
Prepaid expenses and other assets	9,599	
Deferred financing costs, net	2,550	
Intangible assets, net	1,145	

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Total assets	\$ 532,122
<hr/>	
Liabilities and Shareholders' Equity	
Deed of trust and other notes payable	\$ 447,524
Accounts payable and accrued expenses	3,977
Accrued interest on notes payable	1,933
Consideration due for completed acquisitions	-
Deferred revenue and security deposits	2,413
<hr/>	
Total liabilities	455,847
Minority interest in operating partnership	20,848
Shareholders' equity:	
Common stock, \$.01 par value, 100,000,000 shares authorized; 10,428,754 shares issued and outstanding at June 30, 2006, 10,385,890 shares issued and outstanding at December 31, 2005 (including 200,000 nonvested shares issued and outstanding at both dates)	102
Additional paid-in capital	123,315
Dividend distributions in excess of net income	(67,990)
<hr/>	
Total shareholders' equity	55,427
<hr/>	
Total liabilities and shareholders' equity	\$ 532,122
<hr/>	

See accompanying notes

3

BNP RESIDENTIAL PROPERTIES, INC.

Consolidated Statements of Operations - Unaudited  
(all amounts in thousands except per share amounts)

	Three months ended June 30		Six months e June 30
	2006	2005	2006
	<hr/>		<hr/>
Revenues			
Apartment rental income	\$ 19,697	\$ 17,178	\$ 38,698
Restaurant rental income	957	957	1,915
Interest and other income	54	31	236
	<hr/>		<hr/>
	20,709	18,166	40,849
Expenses			
Apartment operations	7,561	6,681	14,823
Apartment administration	886	738	1,794
Corporate administration	806	637	1,827
Interest	6,677	5,667	12,943
Penalties paid at debt refinance	-	3	-
Depreciation	4,785	4,092	9,508
Amortization of deferred loan costs	130	114	266

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Write-off of unamortized loan costs at debt refinance	-	63	-
Deficit distributions to minority partners	90	800	180
	20,934	18,795	41,341
	(225)	(629)	(492)
Loss attributed to minority interests			
- Consolidated limited partnerships	-	14	-
- Operating partnership	45	179	97
Loss from continuing operations	(180)	(436)	(394)
Discontinued operations:			
Income from discontinued operations	-	35	-
(Income) attributed to minority interests	-	(7)	-
Income from discontinued operations, net	-	27	-
Net loss	(180)	(409)	(394)
Less cumulative preferred dividend	-	(250)	-
Loss attributed to common shareholders	\$ (180)	\$ (659)	\$ (394)
Weighted average common shares outstanding	10,418	9,239	10,407
Earnings per common share - basic and diluted:			
Loss from			
- Continuing operations	\$ (0.02)	\$ (0.05)	\$ (0.04)
- Discontinued operations	-	0.01	-
Net loss	(0.02)	(0.04)	(0.04)
Loss attributed to common shareholders	(0.02)	(0.06)	(0.04)
Dividends declared per common share	\$ 0.26	\$ 0.25	\$ 0.52

See accompanying notes

4

BNP RESIDENTIAL PROPERTIES, INC.

Consolidated Statement of Shareholders' Equity - Unaudited  
(all amounts in thousands)

	Common Stock Shares	Amount	Additional paid-in capital	Dividend distributions in excess of net income	
Balance December 31, 2005	10,386	\$ 102	\$ 122,516	\$ (62,189)	\$
Common stock issued	21	-	268	-	
Service cost, nonvested common					

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stock	-	-	86	-
Dividends paid - common	-	-	-	(2,701)
Net loss, first quarter	-	-	-	(214)
<hr/>				
Balance March 31, 2006	10,407	102	122,869	(65,104)
Common stock issued	22	-	360	-
Service cost, nonvested common				
stock	-	-	86	-
Dividends paid - common	-	-	-	(2,706)
Net loss, second quarter	-	-	-	(180)
<hr/>				
Balance June 30, 2006	10,429	\$ 102	\$ 123,315	\$ (67,990)
<hr/>				

See accompanying notes

5

BNP RESIDENTIAL PROPERTIES, INC.

Consolidated Statements of Cash Flows - Unaudited  
(all amounts in thousands)

	Six months ended June 30 2006
	<hr/>
Operating activities:	
Apartment rental receipts, net	\$ 38,962
Restaurant rental receipts	1,915
Interest and other income receipts	123
Operating and administrative expense payments	(18,111)
Interest payments	(12,447)
Penalties paid at debt refinance	-
Net cash provided by operating activities	<hr/> 10,443
Investing activities:	
Acquisitions of apartment properties	(9,344)
Acquisition of Boddie Investment Company, net of cash included in accounts of consolidated limited partnerships	-
Additions to apartment properties, net	(6,151)
Net release (funding) of lender reserves	89
Casualty proceeds	1,141
Net cash used in investing activities	<hr/> (14,265)
Financing activities:	
Net proceeds from issuance of common stock	677
Distributions to minority partners in consolidated limited partnerships	(180)
Distributions to operating partnership minority unitholders	(1,311)
Dividends paid to preferred shareholder	-
Dividends paid to common shareholders	(5,407)
Proceeds from notes payable	20,075
Principal payments on notes payable	(9,171)
Payment of deferred financing costs	(436)

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Net cash provided by financing activities	4,247
Net increase in cash and cash equivalents	425
Cash and cash equivalents at beginning of period	3,111
Cash and cash equivalents at end of period	\$ 3,536

(continued)

6

BNP RESIDENTIAL PROPERTIES, INC.

Consolidated Statements of Cash Flows - Unaudited - continued  
(all amounts in thousands)

	Six months ended June 30 2006
Reconciliation of net loss to net cash provided by operating activities:	
Net loss	\$ (394)
Amortization of intangible for in-place leases at acquisitions	110
Casualty gains	(113)
Amortization of debt premium	(92)
Depreciation and amortization of deferred loan costs	9,774
Depreciation and amortization, discontinued operations	-
Write off of unamortized loan costs at debt refinancing	-
Deficit distributions to minority partners in consolidated limited partnerships	180
Minority interest in consolidated limited partnerships	-
Minority interest in operating partnership	(97)
Service cost related to nonvested common stock	171
Changes in operating assets and liabilities:	
Prepaid expenses and other assets	(2,290)
Accounts payable and accrued expenses	3,110
Deferred revenue, prepaid rent and security deposits	84
Net cash provided by operating activities	\$ 10,443

See accompanying notes

7

BNP RESIDENTIAL PROPERTIES, INC.

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Notes to Consolidated Financial Statements - June 30, 2006  
(Unaudited)

## Note 1. Interim financial statements

We prepared the accompanying condensed consolidated financial statements in accordance with accounting principles generally accepted in the United States ("GAAP") for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. These interim financial statements do not include all information and notes required by GAAP for complete financial statements. However, except as disclosed herein, there has been no material change in the information disclosed in the notes to the consolidated financial statements included in the Annual Report on Form 10-K of BNP Residential Properties, Inc. for the year ended December 31, 2005. You should read these financial statements in conjunction with our 2005 Annual Report on Form 10-K. When we use the terms "we," "us," or "our," we mean BNP Residential Properties, Inc. and all entities included in our consolidated financial statements. We believe that we have included all adjustments (including normal recurring accruals) necessary for a fair presentation. Operating results for the three and six months ended June 30, 2006, are not necessarily indicative of the results that may be expected for the year ending December 31, 2006.

We have reclassified certain amounts in our prior period consolidated financial statements and notes to conform to the current period presentation.

## Note 2. Basis of presentation

These consolidated financial statements include the accounts of BNP Residential Properties, Inc. (the "company") and BNP Residential Properties Limited Partnership (the "operating partnership"). The company is the general partner and owns a majority interest in the operating partnership.

The consolidated financial statements also include the accounts of three real estate limited partnerships (the "limited partnerships") in which we have general partner interests. The assets of consolidated limited partnerships controlled by the operating partnership generally are not available to pay creditors of the company or the operating partnership.

We have eliminated all significant intercompany balances and transactions in the consolidated financial statements.

### Retrospective presentation of 2005 comparative results

In January 2005 we acquired the general partner interest in three limited partnerships. We initially accounted for our investment in one of these partnerships, Villages of Chapel Hill - Phase 5 Limited Partnership ("Villages Phase 5 Partnership") by applying the equity method. During the third quarter of 2005, in accordance with new accounting rules, we consolidated the accounts and activities of this partnership in our consolidated financial statements. In addition, during the fourth quarter of 2005 we sold an apartment property. We have therefore revised the presentation of our operating results for 2005 to reflect these changes on a retrospective basis as follows:

8

Retrospective adjustments for:		
-----		
As currently	Discontinued	Villages Phase 5

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	presented	Operations	Partnership
	(000's)	(000's)	(000's)
Three months ended June 30, 2005			
Revenues	\$ 18,166	\$ (460)	\$ 124
Expenses	18,795	(426)	128
	(629)	(35)	(4)
Loss attributed to minority interests	193	7	1
	(436)	(27)	(3)
Loss from continuing operations			
Income from discontinued operations, net	27	27	-
Net loss	\$ (409)	\$ -	\$ (3)
Six months ended June 30, 2005			
Revenues	\$ 33,201	\$ (895)	\$ 204
Expenses	41,188	(831)	224
	(7,987)	(65)	(20)
Loss attributed to minority interests	1,556	12	4
	(6,431)	(52)	(16)
Loss from continuing operations			
Income from discontinued operations, net	52	52	-
Net loss	\$ (6,379)	\$ -	\$ (16)

These adjustments are insignificant to the consolidated statement of operations and do not change reported earnings per share amounts for the second quarter and first six months of 2005.

Accounting for stock-based compensation

The company has one employee Stock Option and Incentive Plan in place.

Prior to July 1, 2005, we accounted for this plan using the intrinsic value method under the recognition and measurements principles of APB Opinion 25, "Accounting for Stock Issued to Employees," and related interpretations, as permitted by FASB Statement 123, "Accounting for Stock-Based Compensation." No stock-based employee compensation cost was reflected in net income, as all options granted under this plan had an exercise price equal to the market value of the underlying common stock on the date of grant. All outstanding options were fully vested prior to the end of 2004.

Effective July 1, 2005, we adopted the fair value recognition provisions of FASB Statement 123(R), "Share Based Payment," ("FAS 123(R)") using the modified-prospective transition method. Under this transition method, compensation cost includes compensation cost for all share-based payments granted subsequent to July 1, 2005, based on the grant-date fair value estimated in accordance with the provisions of FAS 123(R).

If we had applied the fair value recognition provisions of FAS 123 to options outstanding prior to July 1, 2005, there would have been no impact on net income as reported for the three or six



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months ended June 30, 2005, and no impact on basic and diluted earnings per share amounts as reported.

### Nonvested common stock

Effective August 1, 2005, the Board of Directors granted and issued 200,000 restricted shares of the company's common stock to four of our executive officers. All of the shares were unvested on the date of grant, and will vest 10% per year beginning on July 1, 2006, and on each July 1 thereafter until fully vested. Once vested, the shares will be fully transferable without restriction. All shares carry dividend and voting rights.

Because grantees fully participate in dividends, the fair value of the nonvested shares is equal to the market value at the grant date, \$15.70 per share, or a total of \$3,140,000. Because the grantee group is limited to four key executives, we estimate that 100% of these shares will vest. We will recognize the cost of these awards on a straight-line basis for each annual vesting period ending June 30 through 2015.

During the three and six months ended June 30, 2006, we recorded service cost related to nonvested common stock totaling \$86,000 and \$171,000, respectively, included in corporate administration expense in our statement of operations and as an increase to additional paid-in capital. As of June 30, 2006, unrecognized service cost related to nonvested common stock totaled \$2.8 million.

### Stock options

Options have been granted to employees at prices equal to the fair market value of the stock on the dates the options were granted or repriced. We calculated the fair value of each option grant on the date of grant using the Black-Scholes option-pricing model. Options are generally exercisable in four annual installments beginning one year after the date of grant, and expire ten years after the date of grant.

During the first quarter of 2006, two employees exercised stock options for a total of 7,000 shares of common stock. Changes in outstanding stock options during the three and six months ended June 30, 2006, months were as follows:

	Shares	Weighted Average Exercise Price
	-----	-----
Beginning balance	270,000	\$ 12.08
Exercised	(7,000)	10.11
	-----	-----
Ending balance	263,000	\$ 12.14
	=====	=====
Exercisable at June 30, 2006	263,000	\$ 12.14
	=====	=====

### Note 3. Acquisition and financing transactions

In April 2006, we acquired the Sterling Bluff Apartments, a 144-unit apartment property located in Carrboro, North Carolina, for a contract purchase price of \$9.4 million, from an unaffiliated third party. We funded this acquisition by a draw on our existing revolving line of credit. We operate the apartment community as Bridges at Chapel Hill Apartments.

In May 2006, we issued a \$7.3 million fixed-rate note payable, secured by a deed of trust and assignment of rents of Bridges at Chapel Hill Apartments. The loan provides for interest at

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6.22% (6.3% effective rate), with interest only monthly payments of \$39,000 through June 2012. Beginning July 2012, scheduled monthly installments including principal and interest will be \$45,000, with a balloon payment of \$7.0 million in June 2016. In conjunction with this loan, we paid and recorded deferred loan costs of \$72,000. We applied proceeds of this loan to reduce our revolving line of credit.

Note 4. Shareholders' equity

During the first quarter of 2006, we issued 14,558 shares of our common stock through our Dividend Reinvestment and Stock Purchase Plan ("DRIP") and 7,000 shares of our common stock upon exercise of options by two employees. During the second quarter of 2006, we issued 17,306 shares of our common stock through our DRIP and 4,000 shares of our common stock to certain members of our Board of Directors (1,000 shares to each of our non-management Board members) as part of their annual retainer.

We calculated basic and diluted earnings per common share using the following amounts (in thousands):

	Three months ended June 30		Six months e June 30
	2006	2005	2006
	(000's)	(000's)	(000's)
<b>Numerators:</b>			
-----			
For per common share amounts -			
Net loss	\$ (180)	\$ (409)	\$ (394)
Cumulative preferred dividend	-	(250)	-
	-----	-----	-----
Loss attributed to common shareholders - basic and diluted	\$ (180)	\$ (659)	\$ (394)
	=====	=====	=====
<b>Denominators:</b>			
-----			
For per common share amounts -			
Weighted average common shares outstanding	10,418	9,239	10,407
Less weighted average nonvested common shares outstanding	(200)	-	(200)
	-----	-----	-----
Weighted average common shares - basic	10,218	9,239	10,207
<b>Effect of potentially dilutive securities:</b>			
Convertible operating partnership units (1)	-	-	-
Nonvested common shares (2)	-	-	-
Stock options (3)	-	-	-
	-----	-----	-----
For diluted earnings per share amounts - adjusted weighted average shares and assumed conversions	10,218	9,239	10,207
	=====	=====	=====

- (1) Including operating partnership units would serve to reduce the net loss per share, and they have been excluded from the calculation.
- (2) Including nonvested common shares would serve to reduce the net loss per share, and they have been excluded from the calculation.
- (3) We excluded options to purchase 263,000 shares of common stock at prices ranging from \$9.25 to \$13.125 from the calculation of diluted earnings per share for the three and six months ended June 30, 2006. We also excluded options to purchase 270,000 shares of common stock at prices ranging from \$9.25 to \$13.125 from the calculation of diluted earnings per share for the three and six months ended June 30, 2005. Inclusion of these options would reduce the net loss per share.

Note 5. Commitments

In June 2006, we entered into an exchange agreement with Laurel Springs III, LLC and its members, pursuant to which we will acquire the Laurel Springs Phase 3 Apartments, a 168-unit apartment property that is adjacent to our Laurel Springs community. The purchase price for the property will be \$11.7 million, consisting of the assumption or refinancing of approximately \$10.1 million of debt on the property and \$1.6 million to be paid in operating partnership units with an imputed value of \$16.70 per unit. Under the terms of the exchange agreement, we will complete the acquisition no later than January 2007, and we will issue half of the operating partnership units (approximately 47,000 units) in July 2007 and half in July 2008.

Note 6. Subsequent events

The Board of Directors declared a regular quarterly dividend of \$0.26 per common share on July 20, 2006, payable on August 15, 2006, to shareholders of record as of August 1, 2006.

Effective July 12, 2006, we acquired the Quail Hollow Apartments, a 90-unit apartment property located in Charlotte, North Carolina, for a contract purchase price of \$5.1 million, from an unaffiliated third party. We funded this acquisition by a draw on our existing revolving line of credit. We plan to operate the apartment community as Bridges at Quail Hollow Apartments.

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

This Quarterly Report contains forward-looking statements within the meaning of federal securities law. You can identify such statements by the use of forward-looking terminology, such as "may," "will," "expect," "anticipate," "estimate," "continue" or other similar words. These statements discuss future expectations, contain projections of results of operations or of financial condition or state other "forward-looking" information.

Although we believe that our plans, intentions and expectations reflected in or suggested by these forward-looking statements are reasonable, we cannot assure you that we will achieve our plans, intentions or expectations. When you consider such forward-looking statements, you should keep in mind the following important factors that could cause our actual results to differ materially from those contained in any forward-looking statement:

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- o Our markets could suffer unexpected increases in the development of apartment, other rental or competitive housing alternatives;
- o our markets could suffer unexpected declines in economic growth or an increase in unemployment rates;
- o general economic conditions could cause the financial condition of a large number of our tenants to deteriorate;
- o we may not be able to lease or re-lease apartments quickly or on as favorable terms as under existing leases;
- o a decline in revenues from, or a sale of, our restaurant properties could adversely affect our financial condition and results of operations;
- o we may have incorrectly assessed the environmental condition of our properties;
- o an unexpected increase in interest rates could cause our debt service costs to exceed expectations;
- o we may not be able to meet our long-term liquidity requirements on favorable terms; and
- o we could lose the services of key executive officers.

Given these uncertainties, we caution you not to place undue reliance on forward-looking statements. We undertake no obligation to revise these forward-looking statements if future events or circumstances render them inaccurate.

You should read this discussion in conjunction with the financial statements and notes thereto included in this Quarterly Report and our Annual Report on Form 10-K, including the risk factors disclosed in our Annual Report.

### Company Profile

BNP Residential Properties, Inc. is a self-administered and self-managed real estate investment trust with operations in North Carolina, South Carolina and Virginia. Our primary activity is the ownership and operation of apartment communities. As of June 30, 2006, we owned and managed 31 apartment communities containing 8,090 units, and served as general partner of limited partnerships that owned three properties with 713 units, which we also managed. In addition to our apartment communities, we own 40 restaurant properties that we lease on a triple-net basis to a restaurant operator.

13

We are structured as an UpREIT, or umbrella partnership real estate investment trust. The company is the sole general partner and owns a controlling interest in BNP Residential Properties Limited Partnership, through which we conduct all of our operations. We refer to this partnership as the operating partnership. We refer to the limited partners of the operating partnership as minority unitholders or as the minority interest in the operating partnership.

As of June 30, 2006, we had 10,428,754 shares of common stock outstanding. Our shares are listed on the American Stock Exchange and trade under the symbol "BNP." The operating partnership had an additional 2,608,693 operating partnership minority common units outstanding.

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Our executive offices are located at 301 South College Street, Suite 3850, Charlotte, North Carolina 28202-6024, telephone 704/944-0100.

### Results of Operations

#### Summary

We were pleased with the results of the second quarter of 2006. For the second quarter, funds from operations increased by 12.2%, and funds available for distribution increased by 9.6%, over second quarter of 2005. For the year-to-date period, funds from operations increased by 19.8%, and funds available for distribution increased by 19.2%, over 2005 levels. (We define and discuss funds from operations and funds available for distribution under the caption "Funds from Operations" beginning on page 23 of this Current Report.)

The results for the second quarter reflect the growth in our apartment portfolio and continued improvement in our apartment operations and apartment markets.

Normally, we spend a portion of the second quarter finishing the job of rebuilding occupancy from winter levels and then turn our attention to working toward increasing rental rates. This year was somewhat unusual in that we ended 2005 with good occupancy levels and had strong demand for our apartments throughout the first quarter. As a result, we entered the second quarter in excellent position. This, combined with the fact that the demand for our apartments strengthened throughout the second quarter, led to a 4.7% increase in same-units revenue for the second quarter of 2006 over the second quarter of 2005. For the year-to-date period, same-units apartment revenue for 2006 increased by 4.4% over 2005 levels. While occupancy remained virtually unchanged for both the three- and six-month periods, revenue per occupied unit for these same units increased by 5.1% in the second quarter and 4.1% in the first six months of 2006 compared to 2005.

Apartment expenses have been within our expectations so far this year. On a same-units basis, apartment operations expense increased by 3.1% in the second quarter of 2006, and 3.4% in the first six months of 2006, compared to the same periods in 2005.

As a result of the strong same-unit revenue growth and relatively modest expense growth, we are pleased to report good increases in same-unit apartment NOI (apartment rental income less apartment operating expenses) for both the second quarter and year-to-date periods. On a same-units basis, apartment NOI for the second quarter of 2006 increased by 5.7% compared to the second quarter of 2005. Same-units apartment NOI for the first six months of 2006 increased by 5.0% compared to the first six months of 2005.

For several quarters now we have been discussing the strengthening apartment rental markets and the reasons for this improvement. During the second quarter this strengthening trend continued and, in fact, accelerated somewhat. While we have some concerns, they are general in nature - such as the effect of rapidly rising interest rates, high energy costs and low wage growth on our resident base. We do not see immediate issues, such as over building of competing product, which would lead us to believe that we face an immediate deterioration in market conditions. In fact, we are quite positive that, in the absence of some major economic turmoil or world event that we are simply unable to foresee or predict, we should continue to enjoy reasonably strong market conditions for at least the next few quarters.

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Looking forward, we intend to continue to expand and improve our portfolio. In 2005 we acquired eight apartment properties and the general partner interest in three more. So far this year, we have acquired two apartment properties and have entered a commitment to acquire one more. This slower pace should not be interpreted as a lack of desire, but simply as a matter of discipline. We do not feel compelled to grow for growth's sake and will only acquire a property when we feel that the property enhances the company's overall portfolio and makes economic sense.

We remain committed to the maintenance and improvement of our assets. Our mission is to provide high-quality, middle-market apartments at reasonable prices. We believe that to accomplish this mission we must maintain our apartment assets to very high standards. Not only does this make our properties more attractive to prospective residents, it preserves and enhances the value of our investment. To this end, we have an ongoing maintenance and improvement program that includes both newly acquired and existing properties. In addition to routine maintenance and numerous special projects, we completed exterior rehabilitations of two apartment properties in 2005. We have now begun exterior rehabilitation projects at two more of our properties.

Overall we remain very positive in our outlook. We have worked hard for many years to position our portfolio to benefit from the type of market in which we now find ourselves. We are optimistic that we will continue to see strong occupancy and good growth in rental rates at our apartment communities for the next few quarters.

We provide the following supplemental consolidating information, in response to requests from members of the investment community, for use in comparing our operating results for 2006 and 2005:

15

	2006				
	Consolidated	Elim	Consolidated LPs	Owned Properties	P
	(000's)	(000's)	(000's)	(000's)	
<b>Operating Results - 3 months ended June 30:</b>					
<b>Revenues:</b>					
Apartment rental income	\$ 19,697	\$ -	\$ 1,995	\$ 17,702	\$
Restaurant rental income	957	-	-	957	
Management fee income	8	(100)	-	107	
Casualty gains	-	-	-	-	
Interest and other income	47	(43)	1	89	
	20,709	(143)	1,996	18,855	
<b>Expenses:</b>					
Apartment operations	7,561	(100)	820	6,841	
Administration expenses	1,691	-	-	1,691	
Interest	6,677	(43)	682	6,038	
Penalties paid at debt refinance	-	-	-	-	
Depreciation	4,785	-	394	4,391	

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Amortization, loan costs	130	-	15	115
Write-off of unamortized loan costs at debt refinance	-	-	-	-
Deficit distributions to minority partners of consolidated limited partnerships(2)	90	-	90	-
	20,934	(143)	2,001	19,076
Loss from continuing operations	(225)	-	(4)	(220)
Income from discontinued operations	-	-	-	-
Loss before minority interests	(225)	\$ -	\$ (4)	\$ (220)
Minority interests -				
- Consolidated limited partnerships	-			
- Operating partnership	45			
Net loss	\$ (180)			
Loss before minority interests	\$ (225)	\$ -	\$ (4)	\$ (220)
Casualty gains	-	-	-	-
Cumulative preferred dividend	-	-	-	-
Amortization, lease intangible	44	-	-	44
Depreciation	4,785	-	394	4,391
Depreciation related to discontinued operations	-	-	-	-
Deficit distributions to minority partners of consolidated limited partnerships(1)	90	-	90	-
	4,694	-	480	4,215
Minority interest in FFO of consolidated limited partnerships	(216)	-	(216)	-
Funds from operations(2)	\$ 4,478	\$ -	\$ 264	\$ 4,215

16

2006

	Consolidated	Elim	Consolidated LPs	Owne Properties	P
	(000's)	(000's)	(000's)	(000's)	
Operating Results - 6 months ended June 30:					
Revenues:					
Apartment rental income	\$ 38,698	\$ -	\$ 3,974	\$ 34,724	\$
Restaurant rental income	1,915	-	-	1,915	

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Management fee income	17	(200)	-	217
Casualty gains	113	-	-	113
Interest and other income	107	(85)	4	188
	40,849	(285)	3,977	37,157
Expenses:				
Apartment operations	14,823	(200)	1,648	13,375
Administration expenses	3,621	-	-	3,621
Interest	12,943	(85)	1,351	11,677
Penalties paid at debt refinance	-	-	-	-
Depreciation	9,508	-	788	8,720
Amortization, loan costs	266	-	30	237
Write-off of unamortized loan costs at debt refinance	-	-	-	-
Deficit distributions to minority partners of consolidated limited partnerships(2)	180	-	180	-
	41,341	(285)	3,996	37,630
Loss from continuing operations	(492)	-	(19)	(472)
Income from discontinued operations	-	-	-	-
Loss before minority interests	(492)	\$ -	\$ (19)	\$ (472)
Minority interests -				
- Consolidated limited partnerships	-			
- Operating partnership	97			
Net loss	\$ (394)			
Loss before minority interests	\$ (492)	\$ -	\$ (19)	\$ (472)
Casualty gains	(113)	-	-	(113)
Cumulative preferred dividend	-	-	-	-
Amortization, lease intangible	110	-	-	110
Depreciation	9,508	-	788	8,720
Depreciation related to discontinued operations	-	-	-	-
Deficit distributions to minority partners of consolidated limited partnerships(1)	180	-	180	-
	9,193	-	949	8,245
Minority interest in FFO of consolidated limited partnerships	(435)	-	(435)	-
Funds from operations(2)	\$ 8,759	\$ -	\$ 514	\$ 8,245



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2006

	Consolidated	Elim	Consolidated LPs	Owed Properties	P
	(000's)	(000's)	(000's)	(000's)	
Balance Sheet at June 30, 2006, compared to December 31, 2005:					
Real estate investments	\$ 515,291	\$ -	\$ 41,873	\$ 473,419	\$
Cash and cash equivalents	3,536	-	552	2,985	
Prepaid expenses and other assets	9,599	4,545	794	4,261	
Deferred financing costs, net	2,550	-	421	2,129	
Intangible assets, net	1,145	-	-	1,145	
	<u>\$ 532,122</u>	<u>\$ 4,545</u>	<u>\$ 43,639</u>	<u>\$ 483,939</u>	<u>\$</u>
Notes payable	\$ 447,524	\$ (2,367)	\$ 50,097	\$ 399,795	\$
Accounts payable and accrued expenses	3,977	(20)	266	3,732	
Accrued interest	1,933	-	204	1,729	
Consideration due for acquisitions	-	-	-	-	
Deferred revenue and security deposits	2,413	-	24	2,389	
	<u>455,847</u>	<u>(2,388)</u>	<u>50,591</u>	<u>407,644</u>	
Minority interests - - Consolidated limited partnerships	-	-	-	-	
- Operating partnership	20,848	-	-	20,848	
Shareholders' equity	55,427	6,932	(6,952)	55,446	
	<u>\$ 532,122</u>	<u>\$ 4,545</u>	<u>\$ 43,639</u>	<u>\$ 483,939</u>	<u>\$</u>

- (1) In accordance with GAAP, deficit distributions to minority partners are charges recognized in our statement of operations when cash is distributed to a non-controlling partner in a consolidated limited partnership in excess of the positive balance in such partner's capital account (which is classified as minority interest in our consolidated balance sheet). We are required to record these charges for GAAP purposes even though there is no economic effect or cost to the company or the operating partnership.
- (2) See discussion of funds from operations under the caption "Funds from Operations" below in this Item 2.

Discontinued operations

We sold an apartment community in October 2005, and we present the results of operations of this apartment community as discontinued operations in our comparative statement of operations for 2005. Unless noted otherwise, the following discussion of operating results relates to our continuing operations.

Revenues

Total revenues in the second quarter of 2006 were \$20.7 million, compared to \$18.2 million in the second quarter of 2005. Total revenues in the first six months of 2006 were \$40.8 million, compared to \$33.2 million in the first six months of 2005. These increases are primarily attributable to

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increases in apartment rental income.

18

Apartment rental income totaled \$19.7 million in the second quarter of 2006, an increase of \$2.5 million, or 14.7%, compared to the second quarter of 2005. Apartment rental income in the first six months of 2006 totaled \$38.7 million, an increase of \$7.8 million, or 25.2%, compared to the first six months of 2005. These increases are attributable to:

- o Apartment acquisitions - New communities contributed \$4.5 million in the second quarter and \$8.6 million in the first six months of 2006, compared to \$2.6 million in the second quarter and first six months of 2005. During 2005 we acquired eight new properties, which we operate as seven apartment communities; we acquired the first four of these properties on March 31, 2005. We acquired an additional apartment property in April 2006.
- o Apartment communities that we consolidated effective late January 2005 - These three partial-interest communities generated \$2.0 million in the second quarter and \$4.0 million in the first six months of 2006, compared to \$2.0 million in the second quarter and \$3.2 million in February through June 2005.
- o Revenue increases at "same-units" communities - These communities generated \$13.2 million in the second quarter and \$26.1 million in the first six months of 2006, compared to \$12.6 million in the second quarter and \$25.1 million in the first six months of 2005.

On a "same-units" basis (the 23 apartment communities that we owned as of both January 1, 2005 and 2006), apartment rental income increased by 4.7% in the second quarter of 2006, and 4.4% in the first six months of 2006, compared to the same periods in 2005. These increases are primarily attributable to improvements in rental rates.

On a same-units basis, apartment NOI (apartment rental income less apartment operating expenses) for the second quarter of 2006 increased by 5.7% compared to the second quarter of 2005. Same-units apartment NOI for the first six months of 2006 increased by 5.0% compared to the first six months of 2005.

Summary amounts for our apartment communities' occupancy and revenue per occupied unit for the second quarter and first six months of 2006 follow:

		Three months ended June 30, 2006		Six months ended June 30, 2006
Number of apartment units	Average economic occupancy	Average monthly revenue per occupied unit	Average economic occupancy	Average economic occupancy
Owned apartment communities:				
Same-units communities:				
Abbington Place	360	92.4%	\$ 789	93.0%
Allerton Place	228	97.3%	859	96.0%
Barrington Place	348	95.6%	821	94.0%

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Brookford Place	108	97.4%	702	96.5%
Carriage Club	268	95.8%	791	96.4%
Chason Ridge	252	96.4%	777	97.3%
Fairington	250	94.5%	787	94.8%
Latitudes	448	94.8%	1,025	94.9%

19

		Three months ended June 30, 2006		Six months ended June 30, 2006
	Number of apartment units	Average economic occupancy	Average monthly revenue per occupied unit	Average economic occupancy
Madison Hall	128	92.6%	646	92.8%
Mallard Creek 1	184	92.6%	666	93.3%
Mallard Creek 2	288	94.8%	833	94.7%
Marina Shores Waterfront	290	94.2%	902	94.4%
Oakbrook	162	95.1%	732	95.9%
Oak Hollow 1	222	97.8%	636	97.4%
Oak Hollow 2	240	95.0%	623	94.0%
Paces Commons	336	95.8%	707	95.0%
Paces Village	198	94.5%	716	94.6%
Pelham	144	95.1%	620	96.3%
Pepperstone	108	94.3%	713	94.8%
Savannah Place	172	95.2%	736	96.4%
Southpoint	192	93.2%	718	95.1%
Summerlyn Place	140	93.4%	882	95.2%
Waterford Place	240	96.3%	917	94.7%
Woods Edge	264	93.0%	715	95.3%
Wind River	346	96.1%	856	95.1%
Acquired in 2005:				
Canterbury	630	98.0%	668	97.1%
Hamptons	232	95.2%	765	95.5%
Laurel Springs 1	240	90.3%	628	91.8%
Laurel Springs 2	96	83.1%	833	84.6%
Paces Watch	232	97.8%	884	97.4%
Salem Ridge	120	93.8%	560	95.2%
Timbers	240	92.8%	898	91.7%
Waverly Place	240	96.8%	695	95.3%
Acquired in 2006:				
Chapel Hill	144	89.3%	752	89.3%
All apartments - 2006	8,090	94.9%	773	94.9%

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- 2005	7,474	95.5%	732	94.9%
Same units	5,916			
- 2006		95.0%	788	95.0%
- 2005		95.2%	750	94.9%
Consolidated limited partnerships:				
Marina Shores	392	95.0%	1,232	95.2%
Villages of Chapel Hill	264	95.9%	669	97.4%
Villages - Phase 5	57	97.6%	758	98.1%

Restaurant rental income was \$957,000 in the second quarters of both 2006 and 2005, and \$1.9 million in the first six months of both 2006 and 2005. We received the minimum rent specified in the lease agreement in all periods. We currently hold 40 restaurant properties under this lease, and minimum rent is currently set at \$319,000 per month, or \$3.8 million per year.

20

### Expenses

Total expenses were \$20.9 million in the second quarter of 2006, compared to \$18.8 million in the second quarter of 2005. Total expenses were \$41.3 million in the first six months of 2006, compared to \$41.2 million in the first six months of 2005. The 2006 amounts reflect significant increases in both operating and financing expenses attributable to growth in the size of our apartment operations; however, 2005 amounts include charges related to loan refinance transactions as well as one-time distributions to a minority partner from refinance proceeds totaling \$7.6 million.

Apartment operations expense (the direct costs of on-site operations at owned and consolidated apartment communities) totaled \$7.6 million in the second quarter of 2006, an increase of \$0.9 million, or 13.2%, compared to the second quarter of 2005. Apartment operations expense in the first six months of 2006 totaled \$14.8 million, an increase of \$2.9 million, or 24.0%, compared to the first six months of 2005. These increases are primarily attributable to:

- o Apartment acquisitions - Costs at new communities totaled \$1.7 million in the second quarter and \$3.3 million in the first six months of 2006, compared to \$1.0 million in the second quarter and first six months of 2005. During 2005 we acquired eight new properties, which we operate as seven apartment communities; we acquired the first four of these properties on March 31, 2005. We acquired an additional apartment property in April 2006.
- o Apartment communities that we consolidated effective late January 2005 - Costs at these three partial-interest communities totaled \$0.7 million in the second quarter and \$1.4 million in the first six months of 2006, compared to \$0.7 million in the second quarter and \$1.2 million in February through June 2005.

On a same-units basis, apartment operations expense increased by 3.1% in the second quarter of 2006, and 3.4% in the first six months of 2006, compared to the same periods in 2005, due to expected increases in various operating costs.

Operating expenses for restaurant properties are insignificant because the triple-net lease arrangement requires the lessee to pay virtually all of the expenses associated with the restaurant properties.

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Apartment administration expense (the costs associated with oversight, accounting, and support of our apartment management activities) totaled \$0.9 million in the second quarter of 2006, a 20.0% increase compared to the second quarter of 2005. Apartment administration expense in the first six months of 2006 totaled \$1.8 million, a 27.1% increase compared to the first six months of 2005. These increases are primarily attributable to additional corporate support and operations staff and computer system costs.

Corporate administration expense totaled \$0.8 million in the second quarter of 2006, a 26.6% increase compared to the second quarter of 2005. Corporate administration expense in the first six months of 2006 totaled \$1.8 million, a 20.0% increase compared to the first six months of 2005. This increase is primarily attributable to executive compensation costs, including \$171,000 in charges for service cost related to nonvested common stock issued in August 2005.

21

Interest expense totaled \$6.7 million in the second quarter of 2006, an increase of \$1.0 million, or 17.8%, compared to the second quarter of 2005. Interest expense in the first six months of 2006 totaled \$12.9 million, an increase of \$2.8 million, or 27.2%, compared to the first six months of 2005. These increases are primarily attributable to new debt issued in conjunction with apartment acquisitions, along with the impact of consolidating three limited partnerships for six full months in 2006 (compared to only 5 months in 2005). Overall, weighted average interest rates were 6.0% in the second quarter of 2006 and 5.9% in the first six months of 2006, compared to 5.8% for comparable periods in 2005. The increase in these interest rate measurements reflects the impact of increases in variable interest rates over the last 18 months.

Depreciation expense totaled \$4.8 million in the second quarter of 2006, an increase of \$0.7 million, or 16.9%, compared to the second quarter of 2005. Depreciation expense in the first six months of 2006 totaled \$9.5 million, an increase of \$2.0 million, or 26.0%, compared to the first six months of 2005. These increases are primarily attributable to apartment acquisitions in 2005 and 2006.

We reflect the unaffiliated partners' interests in Marina Shores Associates One, Limited Partnership ("Marina Shores Partnership"), The Villages of Chapel Hill Limited Partnership ("Villages Partnership"), and The Villages of Chapel Hill - Phase 5 Limited Partnership ("Villages Phase 5 Partnership") as minority interest in consolidated limited partnerships. Minority interest in consolidated limited partnerships represents the minority partners' share of the underlying net assets of these consolidated limited partnerships. When these consolidated limited partnerships make cash distributions to partners in excess of the carrying amount of the minority interest, we record a charge equal to the amount of such excess distributions, even though there is no economic effect or cost to the operating partnership. We report this charge in our consolidated statements of operations as deficit distributions to minority partners. We recorded charges for deficit distributions to the minority partner in the Marina Shores Partnership totaling \$90,000 in the second quarter of 2006, compared to \$0.8 million in the second quarter of 2005. We recorded such charges for deficit distributions in the first six months of 2006 totaling \$180,000, compared to \$7.6 million in the first six months of 2005. We currently expect that the Marina Shores Partnership will continue to make regular distributions of approximately \$360,000 per year each to the limited partner and our operating partnership.

Net Income

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Consolidated earnings from continuing operations before non-cash charges (for depreciation, amortization and write-off of unamortized loan costs at refinance) and before the charge for deficit distributions to a minority partner totaled \$4.8 million in the second quarter of 2006, an increase of \$0.3 million, or 7.7%, compared to the second quarter of 2005. Consolidated earnings from continuing operations before non-cash charges and before charges for deficit distributions to a minority partner totaled \$9.5 million in the first six months of 2006, an increase of \$1.8 million, or 24.2%, compared to the first six months of 2005. These increases reflect the impact of new apartment communities and improvements in apartment revenues. In addition, the comparable amounts for 2005 include a first quarter charge of \$0.5 million for penalties paid in conjunction with a refinance transaction for one of the consolidated limited partnerships.

We measure and allocate proportional income and losses of the consolidated limited partnerships to minority partners; however, if those partners' capital accounts have been reduced to \$-0- as a result of previous loss allocations or distributions, we record a charge to absorb the losses that could not be allocated to minority partners' accounts, or we may recover previously absorbed losses or distributions if the limited partnership results are positive.

22

Minority interests absorbed \$45,000 of the consolidated losses from continuing operations in the second quarter, and \$97,000 in the first six months, of 2006. Comparable amounts for loss attributed to minority interests in 2005 were \$193,000 for the second quarter and \$1.6 million for the first six months of 2005. After allocating those losses to minority interests, the net loss from continuing operations was \$0.2 million in the second quarter and \$0.4 million in the first six months of 2006, compared to \$0.4 million in the second quarter and \$6.4 million in the first six months of 2005.

Amounts for discontinued operations reflect the operating results of Savannah Shores Apartments, which we sold in October 2005. Income from discontinued operations, net of the operating partnership minority interest, totaled \$27,000 in the second quarter and \$52,000 in the first six months of 2005.

In November 2005, we redeemed all of the outstanding shares of preferred stock in exchange for shares of our common stock. Because the preferred shareholder had priority over common shareholders for receipt of dividends prior to this conversion, we deducted the amount of net income to be paid to the preferred shareholder, \$250,000 for the second quarter and \$500,000 for the first six months, in calculating net income available to common shareholders for 2005.

The net loss attributed to common shareholders was \$0.2 million in the second quarter and \$0.4 million in the first six months of 2006. Comparable amounts for 2005 were \$0.7 million in the second quarter and \$6.9 million in the first six months.

### Funds from Operations

Funds from operations is frequently referred to as "FFO." FFO is defined by the National Association of Real Estate Investment Trusts ("NAREIT") as "net income (computed in accordance with generally accepted accounting principles), excluding gains (losses) from sales of property, plus depreciation and amortization, and after adjustments for unconsolidated partnerships and joint ventures." Our calculation of FFO is consistent with FFO as defined by

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NAREIT. Because we hold all of our assets in and conduct all of our operations through the operating partnership, we measure FFO at the operating partnership level (i.e., after deducting the minority interests in FFO of the consolidated limited partnerships, but before deducting the minority interest in the operating partnership).

Historical cost accounting for real estate assets implicitly assumes that the value of real estate assets diminishes predictably over time. In fact, real estate values have historically risen or fallen with market conditions. FFO is intended to be a standard supplemental measure of operating performance that excludes historical cost depreciation from - or "adds it back" to - GAAP net income. We consider FFO to be useful in evaluating potential property acquisitions and measuring operating performance.

Funds available for distribution is frequently referred to as "FAD." We define FAD as FFO plus non-cash expenses, plus (less) gains (losses) from sales of property, less recurring capital expenditures. We believe that, together with net income and cash flows from operating activities, FAD provides investors with an additional measure to evaluate the ability of the operating partnership to incur and service debt, to fund acquisitions and other capital expenditures, and to fund distributions to shareholders and minority unitholders.

23

Funds from operations and funds available for distribution do not represent net income or cash flows from operations as defined by GAAP. Nor do FFO or FAD measure whether cash flow is sufficient to fund all of our cash needs, including principal amortization, capital improvements and distributions to shareholders and unitholders. You should not consider FFO or FAD to be alternatives to net income as reliable measures of the company's operating performance; nor should you consider FFO or FAD to be alternatives to cash flows from operating, investing or financing activities (as defined by GAAP) as measures of liquidity. Further, FFO and FAD as disclosed by other REITs might not be comparable to our calculation of FFO or FAD.

Funds from operations totaled \$4.5 million in the second quarter of 2006, an increase of \$0.5 million, or 12.2%, compared to the second quarter of 2005. Funds from operations in the first six months of 2006 totaled \$8.8 million, an increase of \$1.4 million, or 19.8%, compared to the first six months of 2005. These comparisons reflect the positive impact of apartment additions and the improvement in apartment operating results.

Funds available for distribution totaled \$3.6 million in the second quarter of 2006, an increase of \$0.3 million, or 9.6%, compared to the second quarter of 2005. Funds available for distribution for the first six months of 2006 totaled \$7.5 million, an increase of \$1.1 million, or 19.2%, compared to the first six months of 2005. The disparity between comparisons of FFO and FAD against prior year periods arises from the impact of timing of recurring capital expenditures, which we deduct in our measurement of FAD. Recurring capital expenditures include operating replacements such as floor coverings, appliances and HVAC, as well as expenditures for capital replacements such as roofs and exterior paint.

We calculated FFO of the operating partnership as follows:

Three months ended		Six months ended
June 30		June 30
2006	2005	2006
-----		

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	(000's)	(000's)	(000's)	
Net loss	\$ (180)	\$ (409)	\$ (394)	\$
Loss attributed to minority interests	(45)	(186)	(97)	
Cumulative preferred dividend	-	(250)	-	
Casualty gains	-	-	(113)	
Amortization of				
in-place lease intangibles	44	74	110	
Depreciation, continuing operations	4,785	4,092	9,508	
Depreciation related to				
discontinued operations	-	87	-	
Deficit distributions to minority partners				
of consolidated limited partnerships(1)	90	800	180	
Minority interest in FFO of consolidated				
limited partnerships	(216)	(219)	(435)	
Funds from operations	\$ 4,478	\$ 3,990	\$ 8,759	\$

(1) In accordance with GAAP, deficit distributions to minority partners are charges recognized in our statement of operations when a consolidated limited partnership distributes cash to a minority partner in excess of the positive balance in such partner's capital account. We are

24

required to record these charges for GAAP purposes even though there is no cash outlay by the operating partnership. The economic cost of these distributions is borne by the limited partnership making the distributions.

Deficit distributions to minority partners may occur when the fair value of the underlying real estate exceeds its depreciated net book value because the underlying real estate has appreciated or maintained its value. As a result, deficit distributions to minority partners represent, in substance, either our recognition of depreciation previously allocated to the non-controlling partner or a cost related to the non-controlling partner's share of real estate appreciation. Based on NAREIT guidance that requires that real estate depreciation and gains be excluded from FFO, we add back deficit distributions in our reconciliation of net income to FFO.

A reconciliation of net cash provided by operating activities (as defined by GAAP and reflected in our consolidated statements of cash flows) to FAD follows:

	Three months ended		Six months ended	
	June 30		June 30	
	2006	2005	2006	
	(000's)	(000's)	(000's)	
Net cash provided by				
operating activities	\$ 4,984	\$ 4,385	\$ 10,443	\$
Cumulative preferred dividend	-	(250)	-	
Recurring capital expenditures	(1,276)	(850)	(1,941)	
Change in net operating				
assets and liabilities	(120)	209	(904)	
Minority interest in consolidated limited				



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partnerships' share of reconciling items	51	(176)	(135)	
Funds available for distribution	\$ 3,638	\$ 3,318	\$ 7,464	\$

Other information about our historical cash flows follows (all amounts in thousands):

	Three months ended June 30		Six months ended June 30	
	2006	2005	2006	
	(000's)	(000's)	(000's)	
Net cash provided by (used in):				
Operating activities	\$ 4,984	\$ 4,385	\$ 10,443	\$
Investing activities	(12,696)	(37,721)	(14,265)	
Financing activities	8,560	33,290	4,247	

25

	Three months ended June 30		Six months ended June 30	
	2006	2005	2006	
	(000's)	(000's)	(000's)	
Dividends and distributions paid to:				
Preferred shareholders	\$ -	\$ 250	\$ -	\$
Common shareholders	2,706	2,308	5,407	
Minority partners in consolidated limited partnerships	90	800	180	
Minority unitholders in operating partnership	659	450	1,311	
Scheduled debt principal payments	1,154	584	1,921	
Non-recurring capital expenditures	2,383	1,962	4,210	
Weighted average shares outstanding during the period:				
Preferred shares	-	909	-	
Common shares	10,418	9,239	10,407	
Operating partnership minority units	2,609	2,408	2,572	
Shares and units outstanding at end of period:				
Preferred B shares			-	
Common shares			10,429	
Operating partnership minority units			2,609	

Capital Resources and Liquidity

Net cash flows from operating activities totaled \$5.0 million in the

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second quarter of 2006, compared to \$4.4 million in the second quarter of 2005. Net cash flows from operating activities in the first six months of 2006 totaled \$10.4 million, compared to \$7.1 million in the first six months of 2005. The increase in comparative amounts reflects the growth in size of our apartment operations, along with fluctuations in timing of payments for operating assets and liabilities. In addition, cash flows from operating activities in the first quarter of 2005 included \$0.5 million for penalties paid at refinance by a consolidated limited partnership.

In April 2006, we acquired the Sterling Bluff Apartments, a 144-unit apartment property located in Carrboro, North Carolina, for a contract purchase price of \$9.4 million, from an unaffiliated third party. We funded this acquisition by a draw on our existing revolving line of credit. We operate the apartment community as Bridges at Chapel Hill Apartments.

In May 2006, we issued a \$7.3 million fixed-rate note payable, secured by a deed of trust and assignment of rents of Bridges at Chapel Hill Apartments. The loan provides for interest at 6.22% (6.3% effective rate), with interest-only monthly payments through June 2012, then installments of principal and interest of \$45,000 per month, and a balloon payment of \$7.0 million in June 2016. We applied proceeds of this loan to reduce our revolving line of credit.

26

In early July 2006, we acquired the Quail Hollow Apartments, a 90-unit apartment property located in Charlotte, North Carolina, for a contract purchase price of \$5.1 million, from an unaffiliated third party. We funded this acquisition by a draw on our existing revolving line of credit. We plan to operate the apartment community as Bridges at Quail Hollow Apartments.

Other investing and financing activities focused on capital expenditures at apartment communities, along with payment of dividends and distributions.

We have announced that the company will pay a regular quarterly dividend of \$0.26 per share, or approximately \$2.7 million, on August 15, 2006, to shareholders of record of our common stock as of August 1, 2006. We expect to pay regular quarterly distributions totaling approximately \$0.7 million to operating partnership minority unitholders on the same date.

In June 2006, we entered into an exchange agreement with Laurel Springs III, LLC and its members, pursuant to which we will acquire the Laurel Springs Phase 3 Apartments, a 168-unit apartment property that is adjacent to our Laurel Springs community. The purchase price for the property will be \$11.7 million, consisting of the assumption or refinancing of approximately \$10.1 million of debt and \$1.6 million to be paid in operating partnership units with an imputed value of \$16.70 per unit. Under the terms of the exchange agreement, we will complete the acquisition no later than January 2007, and we will issue one-half of the operating partnership units (approximately 47,000 units) in July 2007 and one-half in July 2008.

We generally expect to meet our short-term liquidity requirements through net cash provided by operations and utilization of credit facilities. We believe that net cash provided by operations is, and will continue to be, adequate to meet the REIT operating requirements in both the short term and the long term. We anticipate funding our future acquisition activities primarily by using short-term credit facilities as an interim measure, to be replaced by funds from equity offerings, long-term debt or joint venture investments. We expect to meet our long-term liquidity requirements, such as scheduled debt maturities and repayment of short-term financing of future property acquisitions, through long-term secured and unsecured borrowings and the

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issuance of debt securities or additional equity securities. We believe we have sufficient resources to meet our short-term liquidity requirements.

### Critical Accounting Policies

We identify and discuss our significant accounting policies in the notes to our financial statements included in our Annual Report on Form 10-K. Our policies and practice regarding our accounting for our general partner interests in limited partnerships, for acquisitions, capital expenditures and depreciation, and for stock compensation, which may be of particular interest to readers of this Quarterly Report, are further discussed below.

#### Accounting for general partner interests in limited partnerships

As managing general partner in three real estate limited partnerships, we have the ability to exercise significant influence over operating and financial policies and activities. The appropriate accounting treatment for our interests in these partnerships varies.

If the partnership is considered a variable interest entity ("VIE") and we are the "primary beneficiary," as defined by GAAP, we include the accounts of the partnership in our consolidated financial statements. We initially record all of the VIE's assets, liabilities and minority interests at fair value. We account for our interest in the Villages Partnership using this approach.

27

If we, as general partner, control a partnership that is not a VIE, we also include the accounts of the partnership in our consolidated financial statements. We initially record our prorata interest in the partnership's assets and liabilities at the lower of our cost or fair value; we reflect the minority partners' interest in the partnership's assets and liabilities at historical cost, except to adjust an existing deficit capital account balance to \$-0-. We account for our interests in the Marina Shores Partnership and the Villages Phase 5 Partnership using this approach.

If a consolidated limited partnership makes distributions to a minority partner in excess of the positive balance in such partner's capital account, we record a charge to our earnings for "deficit distributions to minority partners," even though the cash outlay is made by the consolidated limited partnership, and not by our operating partnership.

We allocate proportional income and losses of the consolidated limited partnerships to minority partners; however, we may allocate losses to a minority partner only to the extent of his positive capital account balance. If losses attributable to a minority partner exceed his capital account balance, we record a charge to our earnings to absorb those losses, even though our operating partnership suffers no adverse economic effect.

We may subsequently recover such deficit distributions or absorbed losses if and when the consolidated limited partnership generates positive net income.

#### Purchase price allocation for apartment community acquisitions

In connection with the acquisition of an apartment community, we perform a valuation and allocation to each significant asset and liability in such transaction, based on their estimated fair values at the date of acquisition. Significant tangible asset values generally include real estate investments, which we subsequently depreciate over their estimated useful lives. We include an estimate of intangible asset values, generally consisting of

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at-market, in-place leases, and amortize these amounts over the remaining lease terms as a reduction in reported rental income. In general, we have found that the average remaining life of in-place leases at acquisition date ranged from five to nine months, and such intangible assets represented approximately 0.1% to 0.3% of contract prices.

### Capital expenditures and depreciation

In general, for the 16 apartment properties acquired before 2002, we compute depreciation using the straight-line method over composite estimated useful lives of the related assets, generally 40 years for buildings, 20 years for land improvements, 10 years for fixtures and equipment, and five years for floor coverings.

For apartment properties acquired after 2001, we performed detailed analyses of components of the real estate assets acquired. For these properties, we assigned estimated useful lives, based on age and condition at acquisition, as follows: base building structure, 43-60 years; land improvements, 7-20 years; short-lived building components, 5-20 years; and fixtures, equipment and floor coverings, 5-10 years.

We generally complete and capitalize acquisition improvements (planned expenditures we identify when we acquire the property and that are intended to position the property consistent with our physical standards) within one to two years of acquisition of the related apartment property. We capitalize non-recurring expenditures for additions and betterments to buildings

28

and land improvements. In addition, we generally capitalize recurring capital expenditures for exterior painting, roofing, and other major maintenance projects that substantially extend the useful life of existing assets. For financial reporting purposes, we depreciate these additions and replacements on a straight-line basis over estimated useful lives of 5-20 years. We retire replaced assets with a charge to depreciation for any remaining carrying value. We capitalize all floor covering, appliance, and HVAC replacements, and depreciate them using a straight-line, group method over estimated useful lives of 5-10 years.

We expense ordinary repairs and maintenance costs at apartment communities. Costs of repairs, maintenance, and capital replacements and improvements at restaurant properties are borne by the lessee.

### Impairment of long-lived assets

We evaluate our real estate assets when significant adverse changes in operations or economic conditions occur in order to assess whether any impairment indicators are present that affect the recovery of the recorded values. If we considered any real estate assets to be impaired as defined by GAAP, we would record a loss to reduce the carrying value of the property to its estimated fair value. To date, there have been no such circumstances, and we consider none of our assets to be impaired.

### Revenue recognition

We record rental and other income monthly as it is earned. We record rental payments that we receive prior to the first of a given month as prepaid rent. We hold tenant security deposits in trust in bank accounts separate from operating cash (these amounts are included in other current assets on our balance sheet), and we record a corresponding liability for security deposits on

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our balance sheet.

We amortize any cash concessions given at the inception of an apartment lease over the approximate life of the lease, which is generally one year or less. In general, cash concessions range from \$100 to \$300 and are taken by residents during the first two months of the lease.

### Stock-based compensation

The company has one employee Stock Option and Incentive Plan in place, which we describe in more detail in the notes to our financial statements in our Annual Report on Form 10-K for the year ended December 31, 2005. Prior to July 1, 2005, we accounted for options granted under this plan using the intrinsic value method; no stock-based employee compensation expense was reflected in our earnings, as all outstanding options had been granted at exercise prices equal to market value of the underlying stock on the dates of grant. All outstanding options were fully vested by the end of 2004.

Effective July 1, 2005, we adopted the fair value recognition provisions of Statement No. 123, as revised in 2004 ("FAS 123(R)"), using the modified-prospective transition method. Under this transition method, compensation cost recognized in the second half of 2005 and the first quarter of 2006 includes compensation cost for all share-based payments granted subsequent to July 1, 2005, based on the grant-date fair value estimated in accordance with the provisions of FAS 123(R). Under the modified-prospective transition method, there is no compensation cost recognized for previously granted options that were fully vested prior to July 1, 2005.

29

### Additional information regarding capital expenditures

We provide the following information to analysts and other members of the financial community for use in their detailed analyses.

A summary of capital expenditures for our owned apartment communities during the first six months of 2006, in aggregate and per apartment unit, follows:

	Total	Per
	-----	-----
	(000's)	
Recurring capital expenditures:		
Floor coverings	\$ 594	
Appliances/HVAC	267	
Computer/support equipment	93	
Other	614	
	-----	-----
	\$ 1,568	
	=====	=====
Non-recurring capital expenditures:		
Acquisition improvements at apartment properties	\$ 2,061	
Casualty replacements	1,323	
Additions and betterments at apartment properties	479	
Computer/support equipment	104	
	-----	
	\$ 3,967	

=====

We expense ordinary repairs and maintenance costs at apartment communities. Repairs and maintenance at our owned apartment communities during the first six months of 2006 totaled \$4.9 million, including \$1.8 million in compensation of service staff and \$3.1 million in payments for material and contracted services.

Costs of repairs, maintenance, and capital replacements and improvements at restaurant properties are borne by the lessee.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

All of our long-term debt is secured by real estate investments. As of June 30, 2006, long-term debt, on a consolidated basis, totaled \$447.5 million, including \$388.9 million of notes payable at fixed rates ranging from 5.0% to 7.4%, and \$58.6 million at variable rates indexed primarily on 30-day LIBOR rates. The weighted average interest rate on debt outstanding at June 30, 2006, was 6.0%, compared to 5.9% at March 31, 2006 and 5.8% at December 31, 2005. This trend is primarily attributable to steady increases in variable interest rates. A 1% fluctuation in variable interest rates would increase or decrease our annual interest expense by approximately \$0.6 million.

The table below provides information about our long-term debt instruments and presents expected principal maturities and related weighted average interest rates on instruments in place as of June 30, 2006.

30

	Expected maturity dates					
	2006	2007	2008	2009	2010	Later
-----						
(all dollar amounts in thousands)						
For owned properties:						
Fixed rate notes	\$ 1,057	\$ 2,254	\$41,946	\$31,247	\$20,919	\$243,768
Average interest rate	5.9%	5.9%	6.5%	5.3%	6.8%	5.7%
Variable rate notes	\$ 2,207	\$ 9,177	\$28,595	\$18,625	-	\$ -
Average interest rate	7.4%	7.3%	7.2%	7.2%		
For consolidated limited partnerships:						
Fixed rate notes (1)	\$ 312	\$ 664	\$ 698	\$ 743	\$ 786	\$ 43,594
Average interest rate	5.7%	5.7%	5.7%	5.7%	5.7%	5.8%

(1) Amounts do not include \$0.9 million debt premium to adjust one loan to fair value in consolidation.

Item 4. Controls and Procedures

We maintain disclosure controls and procedures designed to ensure that information disclosed in our annual and periodic reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. In addition, we designed these disclosure controls and procedures to

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ensure that this information is accumulated and communicated to our management, including our chairman, chief executive officer and chief financial officer, to allow timely decisions regarding required disclosures.

Based on our most recent evaluation, which was completed as of the end of the second quarter of 2006, our chairman, chief executive officer and chief financial officer believe that our disclosure controls and procedures are effective. There were no changes in our internal control over financial reporting identified in connection with our second quarter 2006 evaluation of such internal control that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

### Part II - Other Information

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

We held our Annual Meeting of Shareholders on May 18, 2006. Of the 10,407,448 shares of common stock issued, outstanding, and entitled to vote at this meeting, 9,353,568 shares, or 89.9%, were present in person or by proxy. The following proposal was approved:

	For	Against	Withheld/ Abstained
Election of directors to serve until the 2009 annual meeting:			
W. Michael Gilley	7,949,511	-0-	1,404,057
Peter J. Weidhorn	8,308,455	-0-	1,045,113

31

Other directors, whose terms of office as directors continue after the meeting, are as follows:

Serving until the 2007 annual meeting:

Philip S. Payne  
Stephen R. Blank

Serving until the 2008 annual meeting:

D. Scott Wilkerson  
Paul G. Chrysson

#### Item 5. Other Information

##### Re-appointment of officers

The Board of Directors re-appointed the following executive officers effective May 18, 2006:

Philip S. Payne	Chairman
D. Scott Wilkerson	President and Chief Executive Officer
Pamela B. Bruno	Vice President, Treasurer, Chief Financial Officer, and Assistant Secretary
Eric S. Rohm	Vice President, Secretary, and General Counsel

#### Item 6. Exhibits

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The Registrant agrees to furnish a copy of all agreements related to long-term debt upon request of the Commission.

Exhibit No.

- 31.1 Rule 13a-14(a)/15d-14(a) Certification by Chairman
- 31.2 Rule 13a-14(a)/15d-14(a) Certification by Chief Executive Officer
- 31.3 Rule 13a-14(a)/15d-14(a) Certification by Chief Financial Officer
- 32.1 Section 1350 Certification by Chairman, Chief Executive Officer, and Chief Financial Officer

32

SIGNATURES

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

BNP RESIDENTIAL PROPERTIES, INC.  
(Registrant)

August 1, 2006

/s/ Philip S. Payne

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Philip S. Payne  
Chairman

August 1, 2006

/s/ Pamela B. Bruno

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Pamela B. Bruno  
Vice President, Treasurer and  
Chief Financial Officer

33

INDEX TO EXHIBITS

Exhibit No.

- 31.1 Rule 13a-14(a)/15d-14(a) Certification by Chairman



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- 31.2 Rule 13a-14(a)/15d-14(a) Certification by Chief Executive Officer
- 31.3 Rule 13a-14(a)/15d-14(a) Certification by Chief Financial Officer
- 32.1 Section 1350 Certification by Chairman, Chief Executive Officer, and Chief Financial Officer