

BRANDYWINE REALTY TRUST

Form 10-Q

May 09, 2008

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-Q**

(Mark One)

☒ **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the quarterly period ended March 31, 2008**

**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**

**001-9106 (Brandywine Realty Trust)  
000-24407 (Brandywine Operating Partnership,  
L.P.)**

**Brandywine Realty Trust  
Brandywine Operating Partnership, L.P.  
(Exact name of registrant as specified in its charter)**

**MARYLAND** (Brandywine Realty Trust)  
**DELAWARE** (Brandywine Operating Partnership L.P.)

**23-2413352  
23-2862640**

(State or other jurisdiction of  
Incorporation or organization)

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

**555 East Lancaster Avenue  
Radnor, Pennsylvania**

**19087**

(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code **(610) 325-5600**

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.

Brandywine Realty Trust

Yes ☒ No ☐

Brandywine Operating Partnership, L.P.

Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, accelerated filer, or a non-accelerated filer. See definitions of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Brandywine Realty Trust:	Large accelerated filer <input checked="" type="checkbox"/> Accelerated filer <input type="checkbox"/> Non-accelerated filer <input type="checkbox"/> Smaller reporting company <input type="checkbox"/>
Brandywine Operating Partnership, L.P.:	Large accelerated filer <input checked="" type="checkbox"/> Accelerated filer <input type="checkbox"/> Non-accelerated filer <input type="checkbox"/> Smaller reporting company <input type="checkbox"/>

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

Brandywine Realty Trust

Yes ☐ No ☐

Brandywine Operating Partnership, L.P.

Yes ☐ No ☐

A total of 87,603,718 Common Shares of Beneficial Interest, par value \$0.01 per share, were outstanding as of May 5, 2008.

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COMPUTATION OF RATIOS OF BRANDYWINE REALTY TRUST

COMPUTATION OF RATIOS OF BRANDYWINE OPERATING PARTNERSHIP

Certification of Chief Executive Officer

Certification of Chief Financial Officer

Certification of Chief Executive Officer, in its capacity as the general partner

Certification of Chief Financial Officer, in its capacity as the general partner

Certification of Chief Executive Officer, Pursuant to Section 906

Certification of Chief Financial Officer, Pursuant to Section 906

Certification of Chief Executive Officer, in its capacity as the general partner, Pursuant to Section 906

Certification of Chief Financial Officer, in its capacity as the general partner, Pursuant to Section 906

**Filing Format**

This combined Form 10-Q is being filed separately by Brandywine Realty Trust and Brandywine Operating Partnership, L.P.

**Table of Contents****PART I FINANCIAL INFORMATION****Item 1. Financial Statements**

**BRANDYWINE REALTY TRUST**  
**CONSOLIDATED BALANCE SHEETS**  
(unaudited, in thousands, except share and per share information)

	<b>March 31, 2008</b>	<b>December 31, 2007</b>
<b>ASSETS</b>		
Real estate investments:		
Operating properties	\$ 4,815,994	\$ 4,813,563
Accumulated depreciation	(589,115)	(558,908)
Operating real estate investments, net	4,226,879	4,254,655
Development land and construction-in-progress	425,949	402,270
Total real estate investments, net	4,652,828	4,656,925
Cash and cash equivalents	3,852	5,600
Accounts receivable, net	14,065	17,057
Accrued rent receivable, net	87,623	83,098
Investment in real estate ventures, at equity	72,310	71,598
Deferred costs, net	89,202	87,123
Intangible assets, net	204,627	218,149
Other assets	76,295	74,549
Total assets	\$ 5,200,802	\$ 5,214,099
<b>LIABILITIES AND BENEFICIARIES EQUITY</b>		
Mortgage notes payable	\$ 608,337	\$ 611,898
Unsecured term loan	150,000	150,000
Unsecured notes, net of discounts	2,183,981	2,208,344
Unsecured credit facility	138,447	130,727
Accounts payable and accrued expenses	112,884	80,732
Distributions payable	42,336	42,368
Tenant security deposits and deferred rents	65,747	65,241
Acquired below market leases, net	63,249	67,281
Other liabilities	38,964	30,154
Total liabilities	3,403,945	3,386,745
Minority interest	80,992	84,119
Commitments and contingencies (Note 14)		
Beneficiaries' equity:		
Preferred Shares (shares authorized-20,000,000):		
7.50% Series C Preferred Shares, \$0.01 par value; issued and outstanding- 2,000,000 in 2008 and 2007	20	20
7.375% Series D Preferred Shares, \$0.01 par value; issued and outstanding- 2,300,000 in 2008 and 2007	23	23

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Common Shares of beneficial interest, \$0.01 par value; shares authorized 200,000,000; 88,612,439 and 88,623,635 issued in 2008 and 2007, respectively and 87,201,332 and 87,015,600 outstanding in 2008 and 2007, respectively

	871	870
Additional paid-in capital	2,319,355	2,319,410
Common shares in treasury, at cost, 1,411,107 and 1,599,637 in 2008 and 2007, respectively	(50,268)	(53,449)
Cumulative earnings	494,856	480,217
Accumulated other comprehensive loss	(6,489)	(1,885)
Cumulative distributions	(1,042,503)	(1,001,971)
Total beneficiaries equity	1,715,865	1,743,235
Total liabilities, minority interest and beneficiaries equity	\$ 5,200,802	\$ 5,214,099

The accompanying notes are an integral part of these consolidated financial statements.

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**BRANDYWINE REALTY TRUST**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
(unaudited, in thousands, except share and per share information)

	For the three-month periods ended March 31,	
	2008	2007
<b>Revenue:</b>		
Rents	\$ 137,472	\$ 137,346
Tenant reimbursements	19,751	20,619
Termination fees	3,257	1,329
Third party management fees, labor reimbursement and leasing	5,679	4,335
Other	832	1,168
Total revenue	166,991	164,797
<b>Operating Expenses:</b>		
Property operating expenses	45,456	45,040
Real estate taxes	16,903	15,922
Third party management expenses	2,246	2,495
Depreciation and amortization	55,871	61,906
General & administrative expenses	5,004	7,269
Total operating expenses	125,480	132,632
<b>Operating income</b>	41,511	32,165
<b>Other Income (Expense):</b>		
Interest income	209	787
Interest expense	(37,450)	(40,358)
Interest expense    Deferred financing costs	(1,508)	(1,258)
Equity in income of real estate ventures	1,115	754
Net loss on disposition of undepreciated real estate	(24)	
Gain on early extinguishment of debt	3,356	
<b>Income (loss) before minority interest and discontinued operations</b>	7,209	(7,910)
Minority interest    partners    share of consolidated real estate ventures	(40)	(116)
Minority interest attributable to continuing operations    LP units	(217)	428
<b>Income (loss) from continuing operations</b>	6,952	(7,598)
<b>Discontinued operations:</b>		
Income from discontinued operations	53	2,164
Net gain on disposition of discontinued operations	7,981	26,009
Minority interest attributable to discontinued operations    LP units	(338)	(1,203)
Income from discontinued operations	7,696	26,970
<b>Net income</b>	14,648	19,372



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Income allocated to Preferred Shares	(1,998)	(1,998)
<b>Income allocated to Common Shares</b>	<b>\$ 12,650</b>	<b>\$ 17,374</b>
<b>Basic earnings (loss) per Common Share:</b>		
Continuing operations	\$ 0.06	\$ (0.11)
Discontinued operations	0.09	0.31
	\$ 0.15	\$ 0.20
<b>Diluted earnings (loss) per Common Share:</b>		
Continuing operations	\$ 0.06	\$ (0.11)
Discontinued operations	0.09	0.30
	\$ 0.15	\$ 0.19
<b>Dividends declared per Common Share</b>	<b>\$ 0.44</b>	<b>\$ 0.44</b>
<b>Basic weighted average shares outstanding</b>	<b>87,073,721</b>	<b>88,287,426</b>
<b>Diluted weighted average shares outstanding</b>	<b>87,088,131</b>	<b>89,236,342</b>

The accompanying notes are an integral part of these consolidated financial statements.

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**BRANDYWINE REALTY TRUST**  
**CONSOLIDATED STATEMENTS OF OTHER COMPREHENSIVE INCOME**  
**(unaudited, in thousands)**

	<b>For the three-month periods ended March 31,</b>	
	<b>2008</b>	<b>2007</b>
Net income	\$ 14,648	\$ 19,372
Other comprehensive income:		
Unrealized gain (loss) on derivative financial instruments	(4,832)	1,450
Reclassification of realized (gains) losses on derivative financial instruments to operations, net	(20)	9
Unrealized gain (loss) on available-for-sale securities	248	(607)
Total other comprehensive income (loss)	(4,604)	852
Comprehensive income	\$ 10,044	\$ 20,224

The accompanying notes are an integral part of these consolidated financial statements.

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**BRANDYWINE REALTY TRUST**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(unaudited, in thousands)

	<b>Three-month periods ended March 31,</b>	
	<b>2008</b>	<b>2007</b>
<b>Cash flows from operating activities:</b>		
Net income	\$ 14,648	\$ 19,372
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation	40,363	48,508
Amortization:		
Deferred financing costs	1,509	1,257
Deferred leasing costs	4,090	3,842
Acquired above (below) market leases, net	(2,278)	(3,613)
Acquired lease intangibles	11,488	14,247
Deferred compensation costs	1,307	1,213
Straight-line rent	(6,609)	(7,063)
Provision for doubtful accounts	1,250	500
Real estate venture income in excess of distributions	(544)	(84)
Net gain on sale of interests in real estate	(7,957)	(26,009)
Gain on early extinguishment of debt	(3,356)	
Minority interest	595	891
Changes in assets and liabilities:		
Accounts receivable	3,906	5,416
Other assets	(2,808)	(11,167)
Accounts payable and accrued expenses	20,264	7,286
Tenant security deposits and deferred rents	1,032	3,390
Other liabilities	(2,732)	(7,465)
Net cash from operating activities	74,168	50,521
<b>Cash flows from investing activities:</b>		
Acquisition of minority interest partners share of consolidated real estate venture		(63,732)
Sales of properties, net	26,172	109,127
Capital expenditures	(38,798)	(68,015)
Investment in unconsolidated real estate ventures	(249)	(512)
Cash distributions from unconsolidated real estate ventures in excess of equity in income	81	1,849
Leasing costs	(3,851)	(9,259)
Net cash used in investing activities	(16,645)	(30,542)
<b>Cash flows from financing activities:</b>		
Proceeds from Credit Facility borrowings	57,000	442,000
Repayments of Credit Facility borrowings	(49,280)	(98,000)
Repayments of mortgage notes payable	(3,561)	(4,695)
Repayments of unsecured notes	(21,027)	(299,866)
Debt financing costs	(85)	(72)

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Exercise of stock options		6,166
Repurchases of Common Shares		(44,677)
Distributions paid to shareholders	(40,514)	(41,031)
Distributions to minority interest holders	(1,804)	(1,298)
Net cash used in financing activities	(59,271)	(41,473)
Decrease in cash and cash equivalents	(1,748)	(21,494)
Cash and cash equivalents at beginning of period	5,600	25,379
Cash and cash equivalents at end of period	\$ 3,852	\$ 3,885
Supplemental disclosure:		
Cash paid for interest, net of capitalized interest	\$ 18,163	\$ 24,023
Supplemental disclosure of non-cash activity:		
Cash escrowed with qualified intermediary		109,102

The accompanying notes are an integral part of these consolidated financial statements.

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**BRANDYWINE REALTY TRUST**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**  
**March 31, 2008**

**1. THE COMPANY**

Brandywine Realty Trust, a Maryland real estate investment trust, or REIT, is a self-administered and self-managed real estate investment trust, or REIT, active in acquiring, developing, redeveloping, leasing and managing office and industrial properties. Brandywine Realty Trust owns its assets and conducts its operations through Brandywine Operating Partnership, L.P. a Delaware limited partnership (the Operating Partnership) and subsidiaries of the Operating Partnership. Brandywine Realty Trust, the Operating Partnership and their consolidated subsidiaries are collectively referred to below as the Company. The Company's common shares of beneficial interest are publicly traded on the New York Stock Exchange under the ticker symbol BDN.

As of March 31, 2008, the Company owned 215 office properties, 22 industrial facilities and one mixed-use property (collectively, the Properties) containing an aggregate of approximately 24.7 million net rentable square feet. The Company also had seven properties under development and seven properties under redevelopment containing an aggregate 3.6 million net rentable square feet. As of March 31, 2008, the Company consolidated three office properties owned by real estate ventures containing 0.4 million net rentable square feet. Therefore, as of March 31, 2008, the Company owned and consolidated 255 properties containing an aggregate of 28.7 million net rentable square feet. As of March 31, 2008, the Company also owned economic interests in 14 unconsolidated real estate ventures that contain approximately 4.4 million net rentable square feet (collectively, the Real Estate Ventures). The Properties and the properties owned by the Real Estate Ventures are located in and surrounding Philadelphia, PA, Wilmington, DE, Southern and Central New Jersey, Richmond, VA, Metropolitan Washington, D.C., Austin, TX and Oakland, Carlsbad and Rancho Bernardo, CA.

Brandywine Realty Trust is the sole general partner of the Operating Partnership and, as of March 31, 2008, owned a 95.8% interest in the Operating Partnership. The Company conducts its third-party real estate management services business primarily through wholly-owned management company subsidiaries.

As of March 31, 2008, the management company subsidiaries were managing properties containing an aggregate of approximately 41.4 million net rentable square feet, of which approximately 28.3 million net rentable square feet related to Properties owned by the Company and approximately 13.1 million net rentable square feet related to properties owned by third parties and Real Estate Ventures.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Basis of Presentation**

The consolidated financial statements have been prepared by the Company pursuant to the rules and regulations of the U.S. Securities and Exchange Commission. Certain information and footnote disclosures normally included in the financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the included disclosures are adequate to make the information presented not misleading. In the opinion of management, all adjustments (consisting solely of normal recurring matters) for a fair statement of the financial position of the Company as of March 31, 2008, the results of its operations for the three-month periods ended March 31, 2008 and 2007 and its cash flows for the three-month periods ended March 31, 2008 and 2007 have been included. The results of operations for such interim periods are not necessarily indicative of the results for a full year. These consolidated financial statements should be read in conjunction with the Company's consolidated financial statements and footnotes included in the Company's 2007 Annual Report on Form 10-K. Certain prior period amounts have been reclassified to conform to the current period presentation. The reclassifications are primarily due to the treatment of sold properties as discontinued operations on the statement of operations for all periods presented and the reclassification of labor reimbursements received under our third party contracts to a gross presentation.

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**BRANDYWINE REALTY TRUST**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**  
**March 31, 2008**

**Principles of Consolidation**

When the Company obtains an economic interest in an entity, the Company evaluates the entity to determine if the entity is deemed a variable interest entity ( VIE ), and if the Company is deemed to be the primary beneficiary, in accordance with FASB Interpretation No. 46R, Consolidation of Variable Interest Entities ( FIN 46R ). When an entity is not deemed to be a VIE, the Company considers the provisions of EITF 04-05, Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights ( EITF 04-05 ). The Company consolidates (i) entities that are VIEs and of which the Company is deemed to be the primary beneficiary and (ii) entities that are non-VIEs which the Company controls and the limited partners do not have the ability to dissolve the entity or remove the Company without cause nor substantive participating rights. Entities that the Company accounts for under the equity method (i.e., at cost, increased or decreased by the Company's share of earnings or losses, plus contributions, less distributions) include (i) entities that are VIEs and of which the Company is not deemed to be the primary beneficiary (ii) entities that are non-VIEs which the Company does not control, but over which the Company has the ability to exercise significant influence and (iii) entities that are non-VIEs that the Company controls through its general partner status, but the limited partners in the entity have the substantive ability to dissolve the entity or remove the Company without cause or have substantive participating rights. The Company will reconsider its determination of whether an entity is a VIE and who the primary beneficiary is, and whether or not the limited partners in an entity have substantive rights, if certain events occur that are likely to cause a change in the original determinations. The portion of these entities not owned by the Company is presented as minority interest as of and during the periods consolidated. All intercompany accounts and transactions have been eliminated in consolidation.

**Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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 date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. Management makes significant estimates regarding revenue, impairment of long-lived assets, allowance for doubtful accounts and deferred costs.

**Operating Properties**

Operating properties are carried at historical cost less accumulated depreciation and impairment losses. The cost of operating properties reflects their purchase price or development cost. Costs incurred for the acquisition and renovation of an operating property are capitalized to the Company's investment in that property. Ordinary repairs and maintenance are expensed as incurred; major replacements and betterments, which improve or extend the life of the asset, are capitalized and depreciated over their estimated useful lives. Fully-depreciated assets are removed from the accounts.

**Purchase Price Allocation**

The Company allocates the purchase price of properties to net tangible and identified intangible assets acquired based on fair values. Above-market and below-market in-place lease values for acquired properties are recorded based on the present value (using an interest rate which reflects the risks associated with the leases acquired) of the difference between (i) the contractual amounts to be paid pursuant to the in-place leases and (ii) the Company's estimate of the fair market lease rates for the corresponding in-place leases, measured over a period equal to the remaining non-cancelable term of the lease. Capitalized above-market lease values are amortized as a reduction of rental income over the remaining non-cancelable terms of the respective leases. Capitalized below-market lease values are amortized as an increase to rental income over the remaining non-cancelable terms of the respective leases, including any below market fixed-rate renewal periods.

Other intangible assets also include amounts representing the value of tenant relationships and in-place leases based on the Company's evaluation of the specific characteristics of each tenant's lease and the Company's overall relationship



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**BRANDYWINE REALTY TRUST**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**  
**March 31, 2008**

with the respective tenant. The Company estimates the cost to execute leases with terms similar to the remaining lease terms of the in-place leases, including leasing commissions, legal and other related expenses. This intangible asset is amortized to expense over the remaining term of the respective leases. Company estimates of value are made using methods similar to those used by independent appraisers or by using independent appraisals. Factors considered by the Company in this analysis include an estimate of the carrying costs during the expected lease-up periods considering current market conditions and costs to execute similar leases. In estimating carrying costs, the Company includes real estate taxes, insurance and other operating expenses and estimates of lost rentals at market rates during the expected lease-up periods, which primarily range from three to twelve months. The Company also considers information obtained about each property as a result of its pre-acquisition due diligence, marketing and leasing activities in estimating the fair value of the tangible and intangible assets acquired. The Company also uses the information obtained as a result of its pre-acquisition due diligence as part of its consideration of FIN 47 *Accounting for Conditional Asset Retirement Obligations* ( FIN 47 ), and when necessary, will record a conditional asset retirement obligation as part of its purchase price.

Characteristics considered by the Company in allocating value to its tenant relationships include the nature and extent of the Company's business relationship with the tenant, growth prospects for developing new business with the tenant, the tenant's credit quality and expectations of lease renewals, among other factors. The value of tenant relationship intangibles is amortized over the remaining initial lease term and expected renewals, but in no event longer than the remaining depreciable life of the building. The value of in-place leases is amortized over the remaining non-cancelable term of the respective leases and any below market fixed-rate renewal periods.

In the event that a tenant terminates its lease, the unamortized portion of each intangible, including market rate adjustments (above or below), in-place lease values and tenant relationship values, would be charged to expense and market rate adjustments would be recorded to revenue.

**Revenue Recognition**

Rental revenue is recognized on the straight-line basis from the later of the date of the commencement of the lease or the date of acquisition of the property subject to existing leases, which averages minimum rents over the terms of the leases. The cumulative difference between lease revenue recognized under this method and contractual lease payment terms is recorded as accrued rent receivable on the accompanying balance sheets. The straight-line rent adjustment increased revenue by approximately \$6.1 and \$7.1 million for the three-month periods ended March 31, 2008 and 2007. Deferred rents on the balance sheet represent rental revenue received prior to their due dates and amounts paid by the tenant for certain improvements considered to be landlord assets that will remain the Company's property at the end of the tenant's lease term. The amortization of the amounts paid by the tenant for such improvements is calculated on a straight-line basis over the term of the tenant's lease and is a component of straight-line rental income and increased revenue by \$0.5 and \$1.5 million for the three-month periods ended March 31, 2008 and 2007. Leases also typically provide for tenant reimbursement of a portion of common area maintenance and other operating expenses to the extent that a tenant's pro rata share of expenses exceeds a base year level set in the lease. Termination fees, third party management fees, labor reimbursement and leasing income are recorded when earned.

**Stock-Based Compensation Plans**

The Company maintains a shareholder-approved equity-incentive plan known as the Amended and Restated 1997 Long-Term Incentive Plan (the 1997 Plan ). The 1997 Plan is administered by the Compensation Committee of the Company's Board of Trustees. Under the 1997 Plan the Compensation Committee is authorized to award equity and equity-based awards, including incentive stock options, non-qualified stock options, restricted shares and performance-based shares. As of March 31, 2008, 4.7 million common shares remained available for future awards under the 1997 Plan. Through March 31, 2008 all options awarded under the 1997 Plan were non-qualified stock options that had a ten-year term. On April 8, 2008, the Compensation Committee awarded incentive stock options exercisable for an aggregate of 1.6 million common shares. These options, together with non-qualified options awarded in March 2008, vest over a three-year period.





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**BRANDYWINE REALTY TRUST**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**  
**March 31, 2008**

On January 1, 2002, the Company began to expense the fair value of stock-based compensation awards granted subsequent to January 1, 2002, over the applicable vesting period as a component of general and administrative expenses in the Company's consolidated Statements of Operations. The Company recognized stock-based compensation expense of \$1.3 million and \$1.2 million during the three-month periods ended March 31, 2008 and 2007, respectively.

**Accounting for Derivative Instruments and Hedging Activities**

The Company accounts for its derivative instruments and hedging activities under SFAS No. 133 ( SFAS 133 ), *Accounting for Derivative Instruments and Hedging Activities*, and its corresponding amendments under SFAS No. 138, *Accounting for Certain Derivative Instruments and Hedging Activities - An Amendment of SFAS 133*. SFAS 133 requires the Company to measure every derivative instrument (including certain derivative instruments embedded in other contracts) at fair value and record them in the balance sheet as either an asset or liability. See disclosures below related to the Company's adoption of Statement of Financial Accounting Standard No. 157, *Fair Value Measurements* . For derivatives designated as fair value hedges, the changes in fair value of both the derivative instrument and the hedged item are recorded in earnings. For derivatives designated as cash flow hedges, the effective portions of changes in the fair value of the derivative are reported in other comprehensive income. The ineffective portions of hedges are recognized in earnings in the current period. For the three-month periods ended March 31, 2008 and 2007, the Company was not party to any derivative contract designated as a fair value hedge and there are no ineffective portions of our cash flow hedges.

The Company actively manages its ratio of fixed-to-floating rate debt. To manage its fixed and floating rate debt in a cost-effective manner, the Company, from time to time, enters into interest rate swap agreements as cash flow hedges, under which it agrees to exchange various combinations of fixed and/or variable interest rates based on agreed upon notional amounts.

**Income Taxes**

Brandywine Realty Trust has elected to be treated as a REIT under Sections 856 through 860 of the Internal Revenue Code of 1986, as amended (the Code ). In order to continue to qualify as a REIT, Brandywine Realty Trust is required to, among other things, distribute at least 90% of its annual REIT taxable income to its stockholders and meet certain tests regarding the nature of its income and assets. As a REIT, Brandywine Realty Trust is not subject to federal and state income taxes with respect to the portion of its income that meets certain criteria and is distributed annually to its stockholders. Accordingly, no provision for federal and state income taxes is included in the accompanying consolidated financial statements with respect to the operations of Brandywine Realty Trust. Brandywine Realty Trust intends to continue to operate in a manner that allows it to meet the requirements for taxation as a REIT. If Brandywine Realty Trust fails to qualify as a REIT in any taxable year, Brandywine Realty Trust will be subject to federal and state income taxes and may not be able to qualify as a REIT for the four subsequent tax years. Brandywine Realty Trust is subject to certain local income taxes. Provision for such taxes has been included in general and administrative expenses in Brandywine Realty Trust's Consolidated Statements of Operations and Comprehensive Income.

Brandywine Realty Trust has elected to treat several of its subsidiaries as REITs under Sections 856 through 860 of the Code. As a result, each subsidiary REIT generally is not subject to federal and state income taxation at the corporate level to the extent it distributes annually at least 100% of its REIT taxable income to its stockholders and satisfies certain other organizational and operational requirements. Each subsidiary REIT has met these requirements and, accordingly, no provision has been made for federal and state income taxes in the accompanying consolidated financial statements. If any subsidiary REIT fails to qualify as a REIT in any taxable year, that subsidiary REIT will be subject to federal and state income taxes and may not be able to qualify as a REIT for the four subsequent taxable years. In addition, this may adversely impact Brandywine Realty Trust's ability to qualify as a REIT. Also, each subsidiary REIT may be subject to local income taxes.



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Brandywine Realty Trust has elected to treat several of its subsidiaries as taxable REIT subsidiaries (each a "TRS"). A TRS is subject to federal, state and local income tax. In general, a TRS may perform additional non-customary services for tenants and generally may engage in any real estate or non-real estate related businesses that are not permitted REIT activities.

**Accounting Pronouncements Adopted January 1, 2008**

Effective January 1, 2008, the Company adopted Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* ("SFAS 157") as amended by FASB Staff Position SFAS 157-1, *Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13* ("FSP FAS 157-1") and FASB Staff Position SFAS 157-2, *Effective Date of FASB Statement No. 157* ("FSP FAS 157-2"). SFAS 157 defines fair value, establishes a framework for measuring fair value in GAAP and provides for expanded disclosure about fair value measurements. SFAS 157 is applied prospectively, including to all other accounting pronouncements that require or permit fair value measurements. FSP FAS 157-1 amends SFAS 157 to exclude from the scope of SFAS 157 certain leasing transactions accounted for under Statement of Financial Accounting Standards No. 13, *Accounting for Leases* for purposes of measurements and classifications. FSP FAS 157-2 amends SFAS 157 to defer the effective date of SFAS 157 for all non-financial assets and non-financial liabilities except those that are recognized or disclosed at fair value in the financial statements on a recurring basis to fiscal years beginning after November 15, 2008.

SFAS 157 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. SFAS 157 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value. Financial assets and liabilities recorded on the Consolidated Balance Sheets are categorized based on the inputs to the valuation techniques as follows:

Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access. Level 2 inputs are inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs may include quoted prices for similar assets and liabilities in active markets, as well as inputs that are observable for the asset or liability (other than quoted prices), such as interest rates, foreign exchange rates, and yield curves that are observable at commonly quoted intervals. Level 3 inputs are unobservable inputs for the asset or liability, which is typically based on an entity's own assumptions, as there is little, if any, related market activity or information. In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset or liability. SFAS 157 was applied to the Company's outstanding derivatives and available-for-sale-securities effective January 1, 2008.

The following table sets forth the Company's financial assets and liabilities that were accounted for, at fair value on a recurring basis as of March 31, 2008:

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**Fair Value Measurements at Reporting  
Date Using:**