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SHELBOURNE PROPERTIES II INC

Form 10-Q

August 14, 2001

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

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2001

Commission file number 0-16341

SHELBOURNE PROPERTIES II, INC.
(Exact name of registrant as specified in its charter)

Delaware ----- (State or other jurisdiction of incorporation or organization)	04-3502382 ----- (I.R.S. Employer Identification No.)
--	--

P.O. Box 9507, 7 Bulfinch Place, Suite 500, Boston, Massachusetts 02114

(Address of principal executive offices)

(617) 570-4600
(Registrant's telephone number, including area code)

5 Cambridge Center, Cambridge, MA 02142
(Former name, former address and former fiscal year,
if changed since last report)

Indicate by check whether the registrant (1) has filed all reports
required to be filed by Section 13 or 15(d) of the Securities Exchange
Act of 1934 during the preceding 12 months (or for such shorter period
that the registrant was required to file such reports), and (2) has
been subject to such filing requirements for the past 90 days.

Yes [X] No []

As of August 13, 2001, there were 1,237,916 shares of common stock
outstanding.

SHELBOURNE PROPERTIES II, INC.

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FORM 10-Q - JUNE 30, 2001

The financial information contained in this Form 10-Q for the periods prior to April 17, 2001 are those of Shelbourne Properties II, Inc.'s predecessor in interest, High Equity Partners L.P. - Series 86 (the "Partnership"). On April 17, 2001, the Partnership was merged with and into Shelbourne Properties II, LP, a limited partnership wholly owned, directly and indirectly, by Shelbourne Properties II, Inc.

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SHELBOURNE PROPERTIES II, INC.

FORM 10-Q - JUNE 30, 2001

BALANCE SHEETS

JUNE 30, 2001

[UNAUDITED]

DECEMBER

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ASSETS

Real estate - net	\$ 45,681,775	\$ 45
Cash and cash equivalents	18,840,062	17
Other assets	3,732,806	3
Receivables - net	178,729	
	-----	-----
	\$ 68,433,372	\$ 67
	=====	=====

LIABILITIES AND EQUITY

Accounts payable and accrued expenses	\$1,332,798	\$1
Due to affiliates	-	
	-----	-----
	1,332,798	1
	-----	-----
Equity:		
Common Stock:		
\$.01 Par Value per share; Authorized 2,500,000 shares; issued and outstanding 1,237,916 shares	12,379	
Additional Capital	66,329,959	
Retained Earnings	758,236	
Limited partners' equity (588,010 units issued and outstanding)	-	62
General partners' equity	-	3
	-----	-----
	67,100,574	65
	-----	-----
	\$ 68,433,372	\$ 67
	=====	=====

See notes to financial statements.

SHELBOURNE PROPERTIES II, INC.

FORM 10-Q - JUNE 30, 2001

STATEMENTS OF OPERATIONS
[UNAUDITED]

FOR THE THREE MONTHS ENDED JUNE 30, FOR THE SI

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	2001	2000	2001
Rental Revenue	\$3,042,154	\$ 2,844,905	\$ 6,096,4
Costs and Expenses:			
Operating expenses	976,043	872,404	1,909,8
Depreciation and amortization	547,963	479,570	1,107,3
Asset management fee	334,378	216,077	666,0
Administrative expenses	350,881	331,784	844,2
Property management fee	91,576	70,579	182,3
	<u>2,300,841</u>	<u>1,970,414</u>	<u>4,709,7</u>
Income before interest and other income	741,313	874,491	1,386,6
Interest income	182,429	183,116	416,0
Other income	8,602	10,050	22,4
Net income	<u>\$ 932,344</u>	<u>\$ 1,067,657</u>	<u>\$ 1,825,0</u>
Earnings Per Share - Basic and Diluted			
Net income per share of common stock	<u>\$.75</u>	<u>\$.86</u>	<u>\$ 1.</u>
Weighted average common shares	<u>1,237,916</u>	<u>1,237,916</u>	<u>1,237,9</u>

See notes to financial statements.

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SHELBOURNE PROPERTIES II, INC.

FORM 10-Q - JUNE 30, 2001

STATEMENT OF EQUITY
[UNAUDITED]

PARTNERS' EQUITY

SHAREHOLDERS' EQUITY

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	GENERAL PARTNERS	LIMITED PARTNERS	COMMON STOCK	ADDITIONAL CAPITAL
	-----	-----	-----	-----
Balance, January 1, 2001	\$ 3,264,724	\$ 62,010,830	\$ -	\$ -
Net income through April 17, 2001	51,439	1,015,345	\$ -	\$ -
Conversion of partnership into REIT	(3,316,163)	(63,026,175)	12,379	66,329,959
Net income subsequent to conversion	-----	-----	-	-----
	-	-		-
Balance, June 30, 2001	\$ -	\$ -	\$ 12,379	\$ 66,329,959
	=====	=====	=====	=====

See notes to financial statements.

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SHELBOURNE PROPERTIES II, INC.

FORM 10-Q - JUNE 30, 2001

STATEMENTS OF CASH FLOWS
[UNAUDITED]

FOR THE SIX MONTHS ENDED
JUNE 30,

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	2001 ----	2000 ----
Cash Flows From Operating Activities:		
Net income	\$1,825,020	\$ 1,920,806
Adjustments to reconcile net income to net Cash provided by operating activities:		
Depreciation and amortization	1,107,374	1,030,995
Straight line adjustment for stepped lease rentals	37,531	15,861
Changes in asset and liabilities:		
Other assets	(499,292)	(289,705)
Receivables	(45,924)	(97,766)
Accounts payable and accrued expenses	(20,758)	(116,968)
Due to affiliates	(512,473)	(203,630)
	-----	-----
Net cash provided by operating activities	1,891,478	2,259,593
	-----	-----
Cash Flows From Investing Activities:		
Improvements to real estate	(658,949)	(306,018)
	-----	-----
Increase in Cash and Cash Equivalents	1,232,529	1,953,575
Cash and Cash Equivalents, Beginning of Year	17,607,533	12,675,936
	-----	-----
Cash and Cash Equivalents, End of Quarter	\$ 18,840,062	\$ 14,629,511
	=====	=====

See notes to financial statements.

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SHELBOURNE PROPERTIES II, INC.

FORM 10-Q - JUNE 30, 2001

NOTES TO FINANCIAL STATEMENTS
[UNAUDITED]

1. GENERAL

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The accompanying financial statements, notes and discussions should be read in conjunction with the financial statements, related notes and discussions contained in the Annual Report on Form 10-K of High Equity Partners, L.P. - Series 86 (the "Partnership") for the year ended December 31, 2000. Effective April 17, 2001, the Partnership was merged with and into Shelbourne Properties II, LP (the "Operating Partnership"), a limited partnership wholly owned, directly and indirectly, by Shelbourne Properties II, Inc. (together with the Operating Partnership, the "Company"). See Note 7.

The financial information contained herein is unaudited; however, in the opinion of management, all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of such financial information have been included. Results of operations for the three and six months ended June 30, 2001 are not necessarily indicative of the results to be expected for the entire year.

2. SIGNIFICANT ACCOUNTING POLICIES

Investment in Joint Ventures

Certain properties are owned in joint ventures with Shelbourne Properties I and/or Shelbourne Properties III, LP, affiliated partnerships that are under common control with the Company. The Company owns, and the Partnership owned, an undivided interest in the assets owned by these joint ventures and is and was severally liable for indebtedness it incurred in connection with its ownership interest in those properties. Therefore, the Company's financial statements present the assets, liabilities, revenues and expenses of the joint ventures on a pro rata basis in accordance with the Company's percentage of ownership.

Real Estate

Real Estate is carried at cost, net of adjustments for impairment. Repairs and maintenance are charged to expense as incurred. Replacement and betterments are capitalized. The Partnership evaluated, and the Company will evaluate the recoverability of the net carrying value of its real estate and related assets at least annually, and more often if circumstances dictated. If this review indicates that the carrying value of a property might not be recoverable, the Partnership prepared, and the Company will prepare estimates of the future undiscounted cash flows expected to result from the use of the property and its eventual disposition, generally over a five-year holding period. In performing this review, management takes into account, among other things, the existing occupancy, the expected leasing prospects of the property and the economic situation in the region where the property was located.

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SHELBOURNE PROPERTIES II, INC.

FORM 10-Q - JUNE 30, 2001

NOTES TO FINANCIAL STATEMENTS
[UNAUDITED]

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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Real Estate (continued)

If the sum of the expected future cash flows, undiscounted, was less than the carrying amount of the property, the Partnership recognized, and the Company will recognize, an impairment loss, and reduced the carrying amount of the property to its estimated fair value. Fair value is the amount at which the property could be bought or sold in a current transaction between willing parties, that is, other than in a forced or liquidation sale. Management estimated and will continue to estimate fair value using discounted cash flows or market comparables, as most appropriate for each property. Independent certified appraisers were utilized to assist management, when warranted.

Impairment write-downs recorded by the Partnership prior to April 17, 2001 did not affect the tax basis of the assets and were not included in the determination of taxable income or loss. No write-downs have been recorded since the effective date of the merger.

Because the expected cash flows used to evaluate the recoverability of the property and their fair values were based upon projections of future economic events, such as property occupancy rates, rental rates, operating cost inflation and market capitalization rates, the amounts ultimately realized at disposition may differ materially from the net carrying values at the balance sheet dates. The cash flows and market comparables used in this process were based on good faith estimates and assumptions developed by management. Unanticipated events and circumstances may occur and some assumptions may not materialize; therefore, actual results may vary materially from the estimates. The Company may in the future provide additional write-downs, which could be material, if real estate markets or local economic conditions change.

Recently Issued Accounting Pronouncements

Effective January 1, 2001, the Statement of Financial Accounting Standards (SFAS) No. 133, "Accounting for Derivative Instruments and Hedging Activities" was adopted by the Partnership. Because the Partnership did not utilize derivatives or engage in hedging activities, this standard did not have a material effect on the Partnership's financial statements and is not expected to have a material effect on the Company's financial statements.

In July 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards "SFAS" No. 141 "Business Combinations". SFAS No. 141 requires that all business combinations be accounted for under the purchase method of accounting. SFAS No. 141 also changes the criteria for the separate recognition of intangible assets acquired in a business combination. SFAS No. 141 is effective for all business combinations initiated after June 30, 2001. This statement will not affect the Company's financial statements.

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2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Recently Issued Accounting Pronouncements (continued)

In July 2001, the FASB issued SFAS No. 142 "Goodwill and Other Intangible Assets". SFAS no. 142 addresses accounting and reporting for intangible assets acquired, except for those acquired in a business combination. SFAS No. 142 presumes that goodwill and certain intangible assets have indefinite useful lives. Accordingly, goodwill and certain intangibles will not be amortized but rather will be tested at least annually for impairment. SFAS No. 142 also addresses accounting and reporting for goodwill and other intangible assets subsequent to their acquisition. SFAS No. 142 is effective for fiscal years beginning after December 15, 2001. This statement will not have a material effect on the Company's financial statements.

3. RELATED PARTY TRANSACTION

Until April 17, 2001, the general partners of the Partnership were entitled to receive certain fees and reimbursement for expenses as permitted under the terms of the Partnership's partnership agreement. Effective April 17, 2001, the Company entered into a contract with Shelbourne Management, LLC ("Shelbourne Management"), which contract has a term of 10 years, pursuant to which Shelbourne Management is to provide the Company with all management, advisory and property management services. Shelbourne Management is owned by Presidio Capital Investment Company, LLC ("PCIC"), an entity controlled and principally owned by affiliates of the senior management of the Company. For providing these services, Shelbourne Management will receive (1) an annual asset management fee, payable quarterly, equal to 1.25% of the gross asset value of Shelbourne as of the last day of each year, (2) property management fees of up to 6% of property revenues, (3) \$150,000 for non-accountable expenses and (4) reimbursement of expenses incurred in connection with the performance of its services.

The fees payable to the general partners to April 17, 2001 and to Shelbourne Management from and after April 17, 2001 consist of (i) a maximum non-accountable expense reimbursement of \$150,000 per year, (ii) an annual management fee of 1.25% of the Gross Asset Value of the Partnership/Company (as defined), (iii) property management fees of up to 6% of property revenues, and (iv) reimbursement of expenses incurred in connection with the performance of its services. Gross asset value is the gross asset value of all assets owned by the Operating Partnership based on the latest appraisal of real estate assets by an independent appraiser of national reputation selected by the advisor and the amount of other assets as reflected on the balance sheet. Since the asset management fee is based on gross assets, the amount payable to Shelbourne Management will increase to the extent the Company acquires new investments, whether for cash, by causing the Company to incur indebtedness or otherwise.

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[UNAUDITED]

3. RELATED PARTY TRANSACTION (CONTINUED)

The following table indicates the amounts paid to general partners and Shelbourne Management on account of such fees for the six month periods ended June 30, 2001 and June 30, 2000.

	Six Months Ended June 30, 2001 [unaudited]	
	General Partners	Shelbourne Management
Expense Reimbursement	\$ 59,444	\$ 40,556
Asset Management Fee	\$394,808	\$271,218

Prior to October 2000, the Partnership had a property management services agreement with Resources Supervisory Management Corp. ("Resources Supervisory"), an affiliate of the general partners, to perform certain functions relating to the management of the properties of the Partnership. A portion of the property management fees were paid to unaffiliated management companies which were engaged for the purpose of performing certain of the management functions for certain properties.

For the quarter ended June 30, 2000, Resources Supervisory was entitled to receive \$70,579. Due to flat fee agreements with certain properties and collection of outstanding receivables \$70,579 was paid to unaffiliated management companies for property management services for the quarter ended June 30, 2000. For the six months ended June 30, 2000, Resources Supervisory was entitled to receive \$172,710. Due to flat fee agreements with certain properties and collection of outstanding receivables, \$165,684 was paid to unaffiliated management companies for property management services with the balance being retained by Resources Supervisory.

Effective October 2000, Kestrel Management L.P. ("Kestrel"), an affiliate of the agent, began performing all property management services directly for the Partnership and, effective April 17, 2001, the Company. For the quarter ended June 30, 2001, Kestrel earned \$91,576. For the six months ended June 30, 2001, Kestrel earned \$182,302.

In connection with the merger, the units of limited partnership interest held by affiliates of the general partners, including those acquired in tender offers made in connection with the settlement of a class action lawsuit were converted into shares of common stock of the Company. In this regard, affiliates of PCIC received 281,232 shares of common stock of the Company representing 22.7% of the total outstanding shares. In addition, pursuant to the terms of the merger, the general partners received an aggregate of 61,896 shares. See Note 7.

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SHELBOURNE PROPERTIES II, INC.

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NOTES TO FINANCIAL STATEMENTS
[UNAUDITED]

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4. REAL ESTATE

The following table is a summary of the Company's real estate as of:

	JUNE 30, 2001	DECEMBER 31, 2000
	-----	-----
	[unaudited]	
Land	\$ 11,669,652	\$ 11,669,652
Buildings and improvements	60,658,184	59,999,235
	-----	-----
	72,327,836	71,668,887
Less: Accumulated depreciation	(26,646,061)	(25,729,457)
	-----	-----
	\$ 45,681,775	\$ 45,939,430
	=====	=====

5. DUE TO AFFILIATES

	JUNE 30, 2001	DECEMBER 31, 2000
	-----	-----
	[unaudited]	
Partnership asset management fee	\$ -	\$ 462,473
Non-accountable expense reimbursement	-	50,000
	-----	-----
Total	\$ -	\$ 512,473
	=====	=====

The amounts payable at December 31, 2000 were paid in the subsequent quarters.

6. FEDERAL INCOME TAX CONSIDERATIONS

As of April 17, 2001, the Partnership was converted into a corporation that will elect to be taxed as a real estate investment trust (REIT) under the provisions of the Internal Revenue Code. See Note 7. As a result, the shareholders of the REIT will be required to include their proportionate share of any distribution of taxable income on their returns. REITs are required to distribute at least 90% of their ordinary taxable income to shareholders and meet certain income, asset and shareholder ownership requirements.

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NOTES TO FINANCIAL STATEMENTS [UNAUDITED]

7. SETTLEMENT OF LAWSUIT

In April 1999, the California Superior Court approved the terms of the settlement of a class action and derivative litigation involving the Partnership. Under the terms of the settlement, the general partners agreed to take the actions described below subject to first obtaining the consent of limited partners to amendments to the Agreement of Limited Partnership of the Partnership summarized below. The settlement became effective in August 1999 following approval of the amendments.

As amended, the Partnership Agreement (a) provided for a Partnership Asset Management Fee equal to 1.25% of the Gross Asset Value of the Partnership (as defined) and (b) fixed the amount that the General Partners would be liable to pay to limited partners upon liquidation of the Partnership as repayment of fees previously received (the "Fee Give-Back Amount"). As of March 31, 2001, the Fee Give-Back Amount was \$3.77 per Unit, subject to reduction by approximately \$.49 per Unit for each full calendar year after 2000 in which liquidation did not occur. As amended, the Partnership Agreement provided that, upon a reorganization of the Partnership into a REIT or other public entity, the general partners would have no further liability to pay the Fee Give-Back Amount. As a result of the conversion of the Partnership into a REIT on April 17, 2001, as described below, the general partners liability to pay the Fee Give-Back Amount was extinguished.

As required by the settlement, an affiliate of the general partners, Millennium Funding III, LLC, made a tender offer to limited partners to acquire up to 39,596 Units (representing approximately 6.7% of the outstanding Units) at a price of \$103.05 per Unit. The offer closed in January 2000 and all 39,596 Units were acquired in the offer.

The final requirement of the settlement obligated the general partners to use their best efforts to reorganize the Partnership into a REIT or other entity whose shares were listed on a national securities exchange or on the NASDAQ National Market System. A Registration Statement was filed with the Securities and Exchange Commission on February 11, 2000 with respect to the restructuring of the Partnership into a publicly traded REIT. On or about February 15, 2001 a prospectus/consent solicitation statement was mailed to the limited partners of the Partnership seeking consent to the reorganization of the Partnership into a REIT.

The consent of limited partners was sought to approve the conversion of the Partnership into the Company. The consent solicitation expired April 16, 2001 and holders of a majority of the units approved the conversion.

On April 17, 2001 the conversion was accomplished by merging the Partnership into the Operating Partnership. Pursuant to the merger, each limited partner of the Partnership received two shares of stock of the Company for each unit they owned, and the general partners received an aggregate of 61,896 shares of stock of the Company in exchange for their general partner interests in the Partnership. The common stock of the Company listed on the American Stock Exchange under the symbol HXE.

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SHELBOURNE PROPERTIES II, INC.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

CAUTIONARY STATEMENTS UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995. Statements contained herein may constitute "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and section 21E of the Securities Exchange Act of 1934, as amended. Any statements contained herein which are not statements of historical facts and that address activities, events or developments that Shelbourne Properties II, Inc. expects, believes or anticipates will or may occur in the future shall be deemed to be forward-looking statements. Forward-looking statements are inherently subject to risks and uncertainties, many of which cannot be predicted with accuracy and some of which might not even be anticipated. Future events, actual results and performance financial and otherwise, could differ materially from those set forth in or contemplated by the forward-looking statements herein. Factors that could cause actual results to differ materially from those in forward-looking statements include the terms of future property sales, investments and financings, general economic and business conditions and various other risk factors listed in the registration statement of Shelbourne Properties II, Inc. filed with the Securities and Exchange Commission.

This item should be read in conjunction with the financial statements and other items contained elsewhere in the report.

On April 17, 2001 Integrated Resources High Equity Partners, Series 86, a California Limited Partnership (the "Partnership") was merged with and into Shelbourne Properties II, LP, a limited partnership wholly owned, directly and indirectly, by Shelbourne Properties II, Inc. Shelbourne Properties II, LP and Shelbourne Properties II, Inc. are collectively referred to as the "Company". Set below is a discussion and analysis of the financial condition of the Company and the historical operations of the Partnership.

LIQUIDITY AND CAPITAL RESOURCES

The Company uses its working capital reserves and any cash from operations as its primary source of liquidity. In addition to cash, unlike the Partnership which could not incur indebtedness or issue additional equity, the Company has as potential sources of liquidity, capital raised by either borrowing money on a long-term or short-term basis, or issuing additional equity securities. Due to the restrictions on debt incurrence in the Partnership and the resulting lack of mortgage debt on the properties, it is anticipated that the Company will have significantly enhanced capital resources as compared to the Partnership. The Company's use of these sources of capital may result in the encumbrance of its current and future assets with substantial amounts of indebtedness. As a result, the Company may have an increased risk of default on its obligations and thus a decrease in its long-term liquidity.

The Company is currently marketing its Matthews Festival, Matthews, NC; Commerce Plaza, Richmond, VA; and Commonwealth Industrial Park, Fullerton, CA properties for sale. In the event that these properties are ultimately sold, the net proceeds from such sale will be distributed, held in reserves or invested in existing or new properties, or a combination thereof.

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SHELBOURNE PROPERTIES II, INC.

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The Company had \$18,840,062 in cash and cash equivalents at June 30, 2001. Cash and cash equivalents are temporarily invested in short-term instruments. The Company's level of liquidity, which is based upon cash and cash equivalents, increased by \$1,232,529 at June 30, 2001 as compared to December 31, 2000. The increase in cash and cash equivalents at June 30, 2001 is due to \$1,891,478 of cash provided by operating activities that was partially offset by \$658,949 of improvements to real estate (investing activities). Currently, the Company's primary source of funds is cash flow from the operation of its properties, principally rents received from tenants that amounted to \$6,096,413 for the six months ended June 30, 2001. In addition, to the extent the Company acquires additional assets, its cash flow from operations would be derived from a larger, more diverse, and potentially riskier group of assets than currently owned. Likewise, the Company's ability to pay dividends may be affected by the leveraging of its assets and reinvestment of sale and financing proceeds for the acquisition of additional assets.

For the three and six months ended June 30, 2001, the Company made \$216,281 and \$658,949 respectively, in capital expenditures that were funded from cash flow and the Company's working capital reserves. In addition to tenant improvements at the properties, capital expenditures consisted of elevator repairs and water piping at Seattle Tower and pylon signage and water line enhancements at Matthews Township Festival Shopping Center. In February 2001, the Seattle area was hit with an earthquake. The damage to Seattle Tower did not effect its operations and it is expected that insurance will cover the costs associated with the damage.

The budgeted expenditures for capital improvements and capitalized tenant procurement cost in 2001 are an aggregate \$4,063,000. These costs are expected to be incurred in the normal course of business and funded from cash flow from the operation of the properties and working capital reserves that are temporarily invested in short-term money market instruments, as well as other sources of capital including financing proceeds and the issuance of additional equity. However, the actual amount of such expenditures depends upon the level of leasing activity and other factors that cannot be predicted with certainty. Because it is possible that the Company will have mortgage indebtedness and a substantially larger pool of real estate assets, thereby increasing expenses, the risk that it may be unable to fund the necessary capital and tenant procurement costs at its properties will likely be increased.

Except as discussed herein, management is not aware of any other trends, events, commitments or uncertainties that will have a significant impact on the Company's liquidity. If, however, real estate market conditions deteriorate in any areas where the properties are located, there is substantial risk that future cash flow may be insufficient to fund the capital improvements and lease procurement costs of the properties. In that event, the Company would utilize its remaining working capital reserves, reduce distributions, raise additional capital through financing or the issuance of equity, or sell one or more properties.

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RESULTS OF OPERATIONS

Six months ended June 30, 2001 vs. June 30, 2000

The Company's net income experienced a decrease of \$95,786 (5%) for the six months ended June 30, 2001 as compared to the same period in the prior year. The decrease in net income for the comparable six month periods was due to an increase in costs and expenses of \$526,590 (12.6%) partially offset by increased rental revenue of \$335,343 (5.8%), interest income of \$83,109 (25%) and other income of \$12,352 (123%).

Rental revenues increased during the six months ended June 30, 2001 compared to 2000 primarily due to increased income from the common area maintenance and real estate tax recoveries along with leasing of vacant space at Commerce Plaza.

Interest income increased during the six months ended June 30, 2001 due to higher cash balances during the six months of 2001 as compared to the comparable period in 2000. This is due to the suspension by the Partnership of distributions until the conditions of the settlement of the lawsuit were met. To the extent that dividends are made in excess of net income, it is expected that interest income will decline in subsequent quarters. Other income increased during the six months ended June 30, 2001 as compared to the same period in 2000 as a result of the increase in the amount of investor servicing transfer fees.

Costs and expenses increased by \$526,590 during the six months ended June 30, 2001 compared to the same period in 2000 due to increases in depreciation and amortization, asset management fees, administrative expenses and property management fees, while operating expenses remained relatively stable for the comparable periods. Depreciation and amortization increased due to significant real estate improvements completed in 2000 and the first six months of 2001 and increased tenant procurement costs due to leasing of vacant spaces at Commerce Plaza. Asset management fees increased for the six months ended June 30, 2001 as compared to the six months ended June 30, 2000 as appraisals were conducted for each property in the second quarter of 2000 that significantly increased the Gross Asset Value of the portfolio owned by the Company. Administrative expenses increased for the six months ended June 30, 2001 as compared to the same period in 2000 primarily due to the costs associated with the conversion of the Partnership into the Company. Property management fees increased due to collections of past receivables, new leases at Commerce Plaza but was offset by the increased vacancies at the Matthews Festival property.

Three months ended June 30, 2001 vs. June 30, 2000

The Company experienced a decrease in net income of \$135,313 (12.7%) for the three months ended June 30, 2001 as compared to the three months ended June 30, 2000. The decrease in net income for the comparable three month period was due to an increase in costs and expenses of \$330,427 (16.8%) partially offset by an increase in rental revenue of \$197,249 (6.9%).

Rental revenues increased during the three months ended June 30, 2001 compared to 2000 primarily due to leasing of vacant spaces at Commerce Plaza.

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Costs and expenses increased for the three months ended June 30, 2001 as compared to the same period in 2000 primarily due to an increase in all expense items. Operating expenses increased \$103,639 for the comparable periods due primarily to increased utility and repairs and maintenance expense. Partnership asset management fees increased \$118,301 due to new appraisals done on individual properties during the second quarter of 2000 which increased the Gross Asset Value. Depreciation and amortization increased \$68,393 due to increased tenant procurement fees and improvements in real estate and property management fees increased \$20,997 due to increase rental revenues. General and administrative costs increased \$19,097 due to the increased costs associated with the operation of the Company as a real estate investment trust.

Inflation is not expected to have a material impact on the operations or financial position of the Company.

FUNDS FROM OPERATIONS

Management believes that Funds From Operations ("FFO") is helpful to investors as a measure of the performance of an equity REIT because, along with cash flows from operating activities, financing activities and investing activities, it provides investors with an understanding of the ability of the Company to incur and service debt, to make capital expenditures and to fund other cash needs.

FFO, which is a commonly used measurement of the performance of an equity REIT, as defined by the National Association of Real Estate Investment Trusts, Inc. ("NAREIT"), is net income (computed in accordance with generally accepted accounting principles), excluding gains (or losses) from debt restructurings, asset valuation provisions and sales of property, plus depreciation and amortization, and after adjustments for unconsolidated partnerships and joint ventures.

The Company's FFO may not be comparable to FFO reported by other REITs that do not define the term in accordance with the current NAREIT definition or that interpret the NAREIT definition differently. FFO does not represent cash generated from operating activities determined in accordance with accounting principles generally accepted in the United States and should not be considered as an alternative to net income (determined in accordance with accounting principles generally accepted in the United States) as a measure of the Company's liquidity, nor is it indicative of funds available to fund the Company's cash needs, including its ability to make cash distributions.

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SHELBOURNE PROPERTIES II, INC.

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FFO for the three and six month periods ended June 30, 2001 and 2000 are summarized in the following table:

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	Three Months Ended		Six Months
	June 30, 2001	June 30, 2000	June 30, 2001
	-----	-----	-----
Net Income	\$ 932,344	\$1,067,657	\$1,825,020
Plus: Depreciation and Amortization related to real estate	547,963	479,570	1,107,374
	-----	-----	-----
Funds From Operations	\$1,480,307	\$1,547,227	\$2,932,394
	=====	=====	=====

OTHER MATTERS

Effective August 15, 2001, Messrs. W. Edward Scheetz and David T. Hamamoto, directors of the Company, have been appointed as Co-Chief Executive Officers of the Company and of its external adviser, Shelbourne Management LLC, in replacement of Mr. Michael L. Ashner, who resigned effective as of such date. Mr. Ashner is the Chief Executive Officer of Kestrel Management, L.P., the entity that, together with its affiliates, will continue to perform administrative and property management services for the Company. The resignation of Mr. Ashner and the other officers of the Company who are employed by Kestrel Management is not expected to have an impact on the operations of the Company.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company does not have any debt instruments. As such, the Company does not have any market risk of interest rate volatility. However, to the extent that interest rates are lowered, interest income on the Company's cash reserves will, accordingly, decrease. The Company does not believe that it has any risk related to derivative financial instruments.

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PART II. OTHER INFORMATION

Item 4 - Submission of Matters to a Vote of Securityholders

Commencing February 15, 2001, consents of the limited partners of the Partnership were solicited to the conversion of the Partnership into a publicly traded real estate investment trust. The consent solicitation period ended on April 16, 2001. Holders of 334,504 units (56.89% of the outstanding units) voted in favor of the conversion, holders of 36,568 units (6.22% of the outstanding units) voted against the conversion and holders of 6,707 units (1.14% of the outstanding units) abstained. The conversion was consummated on April 17, 2001

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and each outstanding limited partnership unit in the Partnership was converted into two shares of common stock of the Company.

Item 6 - Exhibits and Reports on Form 8-K

(a) Exhibits:

99. Press Release dated August 14, 2001

(a) Reports on Form 8-K:

No report on Form 8-K was filed during this period.

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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.

Shelbourne Properties II, Inc.

Dated: August 14, 2001

By: /s/ Michael L.Ashner

President and Director
(Principal Executive Officer)

Dated: August 14, 2001

By: /s/ Dallas E. Lucas

Dallas E. Lucas
Treasurer
(Principal Financial and Accounting Officer)

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EXHIBIT INDEX

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99.

Press Release dated August 14, 2001

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