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MISSION WEST PROPERTIES INC
Form 10-Q
May 10, 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 MARCH 31, 2006

COMMISSION FILE NUMBER 1-8383

Mission West Properties, Inc.
(Exact name of registrant as specified in its charter)

Maryland

95-2635431

(State or other jurisdiction of
incorporation or organization)

(I.R.S. Employer Identification Number)

10050 Bandley Drive
Cupertino, California 95014-2188
(Address of principal executive offices)

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

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

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

Large accelerated filer Accelerated filer Non-accelerated filer

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

APPLICABLE ONLY TO CORPORATE ISSUERS

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

18,511,291 shares outstanding as of April 30, 2006

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MISSION WEST PROPERTIES, INC.
FORM 10-Q
FOR THE QUARTER ENDED MARCH 31, 2006

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Exchange Act of 1934

Exhibit 32 - Certification of CEO and CFO Pursuant to 18 U.S.C. ss. 1350,
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2002

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PART I - FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

MISSION WEST PROPERTIES, INC.

CONSOLIDATED BALANCE SHEETS

(dollars in thousands, except share and per share amounts)

| | March 31, 2006 |
|--|----------------|
| | (unaudited) |
| ----- | |
| ASSETS | |
| Real estate assets, at cost: | |
| Land | \$ 277,269 |
| Buildings and improvements | 775,237 |
| Real estate related intangible assets | 18,784 |
| | ----- |
| Total investments in properties | 1,071,290 |
| Less accumulated depreciation and amortization | (136,370) |
| | ----- |
| Net investments in properties | 934,920 |
| Cash and cash equivalents | 39,937 |
| Restricted cash | 12,698 |
| Deferred rent receivable, net | 18,540 |
| Investment in unconsolidated joint venture | 3,340 |
| Other assets, net | 28,212 |
| | ----- |
| Total assets | \$1,037,647 |
| | ===== |
| LIABILITIES AND STOCKHOLDERS' EQUITY | |
| Liabilities: | |
| Mortgage notes payable | \$ 355,009 |
| Mortgage notes payable (related parties) | 9,955 |
| Interest payable | 321 |
| Security deposits | 6,608 |
| Deferred rental income | 10,585 |
| Dividends and distributions payable | 16,729 |
| Accounts payable and accrued expenses | 10,939 |
| | ----- |
| Total liabilities | 410,146 |
| | ----- |
| Commitments and contingencies (Note 10) | |
| Minority interests | 509,522 |
| | ----- |
| Stockholders' equity: | |
| Preferred stock, \$.001 par value, 20,000,000 shares authorized, none issued and outstanding | - |
| Common stock, \$.001 par value, 200,000,000 shares authorized, 18,511,291 and 18,448,791 shares issued and outstanding at March 31, 2006 and December 31, 2005 | 18 |
| Paid-in-capital | 138,811 |
| Accumulated deficit | (20,850) |

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| | |
|--|-------------|
| Total stockholders' equity | 117,979 |
| Total liabilities and stockholders' equity | \$1,037,647 |

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

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

| | Three months ended March 31, 2006 | 2005 |
|---|--------------------------------------|----------|
| Revenues: | | |
| Rental revenue from real estate | \$24,316 | \$26,247 |
| Tenant reimbursements | 3,309 | 3,628 |
| Lease termination fees | 16,056 | - |
| Other income, including interest | 732 | 303 |
| Total revenues | 44,413 | 30,178 |
| Expenses: | | |
| Property operating, maintenance and real estate taxes | 4,681 | 4,889 |
| Interest | 5,215 | 4,647 |
| Interest (related parties) | 192 | 307 |
| General and administrative | 635 | 675 |
| Depreciation and amortization of real estate | 5,479 | 5,574 |
| Total expenses | 16,202 | 16,092 |
| Income before equity in earnings of unconsolidated joint venture and minority interests | 28,211 | 14,086 |
| Equity in earnings/(loss) of unconsolidated joint venture | 331 | (6) |
| Minority interests | (23,390) | (11,677) |
| Income from continuing operations | 5,152 | 2,403 |
| Discontinued operations, net minority interests: | | |
| Gain from disposal of discontinued operations | - | 14 |
| Loss attributable to discontinued operations | - | (9) |
| Income from discontinued operations | - | 5 |
| Net income available to common stockholders | \$ 5,152 | \$ 2,408 |

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| | | |
|--|------------|------------|
| Net income available to minority interests | \$23,390 | \$11,695 |
| Income per common share from continuing operations: | | |
| Basic | \$0.28 | \$0.13 |
| Diluted | \$0.28 | \$0.13 |
| Income per common share from discontinued operations: | | |
| Basic | - | - |
| Diluted | - | - |
| Net income per common share: | | |
| Basic | \$0.28 | \$0.13 |
| Diluted | \$0.28 | \$0.13 |
| Weighted average shares of common stock outstanding (basic) | 18,455,897 | 18,110,524 |
| Weighted average shares of common stock outstanding (diluted) | 18,520,297 | 18,136,797 |

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

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

Cash flows from operating activities:
Income from continuing operations
Income from discontinued operations
Adjustments to reconcile income from continuing operations to net cash provided by operating activities:
 Minority interest income from continuing operations
 Minority interest income from discontinued operations
 Minority interest distributions
 Depreciation and amortization of real estate and in-place leases
 Depreciation and amortization from discontinued operations
 Amortization of above market lease
 Gain on sale of real estate
 Equity in (earnings)/loss of unconsolidated joint venture
 Distributions from unconsolidated joint venture
 Interest earned on restricted cash
 Lease termination fee income related to restricted cash
 Stock-based compensation expense
 Other
Changes in operating assets and liabilities:

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Deferred rent receivable
Other assets
Security deposits
Deferred rental income
Accounts payable and accrued expenses

Net cash provided by operating activities

Cash flows from investing activities:

Improvements to real estate assets
Proceeds from sale of real estate
Purchase of real estate
Restricted cash used for purchase of real estate
Excess restricted cash

Net cash provided by/(used in) investing activities

Cash flows from financing activities:

Principal payments on mortgage notes payable
Principal payments on mortgage notes payable (related parties)
Net payments under line of credit (related parties)
Proceeds from revolving line of credit
Proceeds from exercised stock options
Distributions paid to minority interests in excess of earnings
Dividends paid

Net cash used in financing activities

Net increase in cash and cash equivalents

Cash and cash equivalents, beginning of period

Cash and cash equivalents, end of period

Supplemental information:

Cash paid for interest

Supplemental schedule of non-cash investing and financing activities:

Issuance of common stock upon conversion of O.P. units

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

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MISSION WEST PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except share, per share, O.P. units and per square footage amounts)

(unaudited)

1. ORGANIZATION AND FORMATION OF THE COMPANY

Mission West Properties, Inc. ("the Company") is a fully integrated, self-administered and self-managed real estate company that acquires and manages R&D/office properties in the portion of the San Francisco Bay Area commonly referred to as Silicon Valley. In July 1998, the Company purchased an approximate 12.11% of four existing limited partnerships (referred to

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collectively as the "operating partnerships") and obtained control of these partnerships by becoming the sole general partner in each one effective July 1, 1998 for financial accounting and reporting purposes. The Company purchased an approximate 12.11% interest in each of the operating partnerships. All limited partnership interests in the operating partnerships were converted into 59,479,633 operating partnership ("O.P.") units, which represented a limited partnership ownership interest of approximately 87.89% of the operating partnerships. The operating partnerships are the vehicles through which the Company holds its real estate investments, makes real estate acquisitions, and generally conducts its business.

On December 30, 1998, the Company was reincorporated under the laws of the State of Maryland through a merger with and into Mission West Properties, Inc. Accordingly, shares of the former company, Mission West Properties, a California corporation (no par), which were outstanding at December 30, 1998, were converted into shares of common stock (\$.001 par value per share) on a one-for-one basis.

As of March 31, 2006, the Company owns a controlling general partnership interest of 17.83%, 21.68%, 16.18% and 12.42% in Mission West Properties, L.P., Mission West Properties, L.P. I, Mission West Properties, L.P. II and Mission West Properties, L.P. III, respectively, which represents a 17.66% general partnership interest in the operating partnerships, taken as a whole, on a consolidated weighted average basis.

Through the operating partnerships, the Company owns interests in 109 R&D properties, all of which are located in Silicon Valley.

The Company has elected to be taxed as a real estate investment trust ("REIT") under the Internal Revenue Code of 1986, as amended. Accordingly, no provision has been made for income taxes for the three months ended March 31, 2006.

BUSINESS SEGMENT INFORMATION

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

2. BASIS OF PRESENTATION

PRINCIPLES OF CONSOLIDATION AND FINANCIAL STATEMENT PRESENTATION

The accompanying unaudited interim consolidated financial statements of the Company have been prepared in accordance with Rule 10-01 of Regulation S-X promulgated by the Securities and Exchange Commission and, therefore, do not include all information and footnotes necessary for a fair presentation of financial position, results of operations and cash flows in conformity with accounting principles generally accepted in the United States of America. In the opinion of the Company, however, the accompanying unaudited interim consolidated financial statements contain all adjustments, consisting only of normal recurring adjustments, necessary to present fairly the Company's consolidated financial position as of March 31, 2006, and its consolidated results of operations for the three months ended March 31, 2006 and 2005, and its cash flows for the three months ended March 31, 2006 and 2005. All significant intercompany balances have been eliminated in consolidation. The consolidated financial statements as of March 31, 2006 and for the three months ended March 31, 2006 and 2005 and related footnote disclosures are unaudited. The results of operations for the three months ended March 31, 2006 are not necessarily indicative of the results

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to be expected for the entire year.

The Company also consolidates all variable interest entities ("VIE") in which it is deemed to be the primary beneficiary in accordance with FASB Interpretation No. 46R ("FIN 46R"). As of March 31, 2006, the Company consolidated one VIE in the accompanying consolidated balance sheets in connection with an assignment of lease agreement with an unrelated party, M&M Real Estate Control & Restructuring, LLC (see Note 5 for further discussion of this transaction). Under the terms of the agreement, the Company, who is the primary beneficiary of that entity, will receive monthly rent payments of approximately \$733 from April 2006 through December 2006, \$545 from January 2007 through August 2007 and \$330 from September 2007 through November 2007.

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MISSION WEST PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED
(dollars in thousands, except share, per share, O.P. units
and per square footage amounts)
(unaudited)

STOCK-BASED OPTION COMPENSATION ACCOUNTING

In December 2004, the FASB issued SFAS No. 123R, "Share-Based Payment" ("SFAS No. 123R"), which addresses the accounting for employee and director stock options. Statement 123R requires that the cost of all employee and director stock options, as well as other equity-based compensation arrangements, be reflected in the financial statements based on the estimated fair value of the awards. SFAS No. 123R is an amendment to SFAS No. 123 and supersedes APB Opinion 25 ("APB 25"). SFAS No. 123R is applicable to any award that is settled or measured in stock, including stock options, restricted stock, stock appreciation rights, stock units, and employee stock purchase plans. At March 31, 2006, the Company had one stock-based option compensation plan. The Company has adopted the requirements of SFAS No. 123R effective January 1, 2006 using the modified prospective method of transition. Accordingly, prior periods have not been restated. The adoption of this standard did not have a material effect on the Company's consolidated statements of operations or financial position.

The Company measures compensation cost for its stock options at fair value on the date of grant and recognizes compensation expense ratably over the vesting period, generally four years. The fair value of the Company's stock options is determined using the Black-Scholes option pricing model. Compensation expense related to the Company's share-based awards is included in general and administrative expense within the Company's consolidated statements of operations.

MINORITY INTERESTS

Minority interest represents the separate private ownership of the operating partnerships by the Berg Group (defined as Carl E. Berg, his brother Clyde J. Berg, members of their respective immediate families, and certain entities they control) and other non-affiliate interests. In total, these interests account for approximately 82.34% of the ownership interests in the real estate operations of the Company as of March 31, 2006. Minority interest in net income is calculated by taking the net income of the operating partnerships (on a stand-alone basis) multiplied by the respective minority interest ownership percentage.

Allocation of corporate general and administrative expenses to the

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operating partnerships is performed based upon shares and operating partnership units outstanding for each operating partnership in relation to the total for all four operating partnerships.

RECLASSIFICATIONS

Certain reclassifications have been made to the previously reported 2005 consolidated financial statements in order to conform to the 2006 presentation.

The following notes, which present interim disclosures as required by the SEC, highlight significant changes to the notes to the Company's December 31, 2005 audited consolidated financial statements and should be read together with the consolidated financial statements and notes thereto included in the Company's 2005 Form 10-K filed on March 16, 2006.

3. REAL ESTATE

On March 9, 2006, the Company acquired a fully leased office/R&D property with approximately 95,700 rentable square feet located at 233 South Hillview Drive in Milpitas, California from Sipex Corporation in a tax-deferred exchange under section 1031 of the Internal Revenue Code of 1986. The total acquisition price for this property was approximately \$13,450 and was funded from the proceeds received from the 800 Embedded Way property sale, which were held by a third party and classified as restricted cash as of December 31, 2005.

The purchase price of the 233 South Hillview Drive acquisition was allocated to long-lived assets and the value of an in-place lease. The in-place lease was valued at fair market so there was no intangible asset allocated to above-or-below market lease value. The Company recorded \$1,374 of the purchase price as real estate related intangible assets in the accompanying consolidated balance sheets for the value of an in-place lease. The intangible assets will be amortized over the applicable remaining lease terms. Amortization expense of \$18 was recorded for the three months ended March 31, 2006.

The purchase price allocation for this acquisition was determined in accordance with the following principles under SFAS No. 141:

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

The capitalized in-place lease value, included in real estate related intangible assets in the accompanying consolidated balance sheets, is amortized to expense as amortization of real estate over the remaining non-cancelable lease term. If a lease were to be

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MISSION WEST PROPERTIES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED
(dollars in thousands, except share, per share, O.P. units
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terminated prior to its stated expiration, all unamortized amounts relating to that lease would be written off in the period that the lease is terminated.

4. RESTRICTED CASH

Restricted cash totaled \$12,698 as of March 31, 2006. Of this amount, \$11,147 represents a balance we consolidated due to the Company's adoption of FIN 46R, "Consolidation of Variable Interest Entities." The Company does not have possession or control over these funds or any right to receive them except in accordance with the payment terms of the lease agreement that has been assigned to the VIE. See Note 5 below for further discussion. The remaining \$1,551 represents a bond the Company posted in the Republic Properties Corporation v. Mission West Properties, L.P. litigation (see Note 10).

5. VARIABLE INTEREST ENTITY

In December 2003, the FASB issued FIN 46R, a revision to FIN 46, which was issued in January 2003. Under FIN 46R, a variable interest entity must be consolidated by a company if that company is subject to a majority of the entity's expected losses or entitled to receive a majority of the entity's expected residual returns or both. FIN 46R requires disclosures about variable interest entities that a company is not required to consolidate, but in which it has a significant variable interest.

In March 2006, one of the Company's tenants, JDS Uniphase ("JDS"), entered into an assignment of lease agreement with an unrelated party, M&M Real Estate Control & Restructuring, LLC ("M&M"), in connection with leases for approximately 252,000 rentable square feet located in San Jose, California. M&M assumed all of JDS's remaining obligations under these leases, acquired certain personal property of JDS located on the premises and received a payment of approximately \$11,147. At the same time, the Company entered into a consent for assignment of lease with both parties and a mutual release agreement with JDS, pursuant to which all of the JDS's obligations under these leases have been effectively transferred to M&M. M&M must continue to perform all of the obligations under the assumed JDS leases and has the right to sublease any or all of the 252,000 rentable square feet vacated by JDS for the remainder of the current lease terms, which expire in 2006 and 2007. Based upon the provisions of FIN 46R, the Company determined that M&M is a variable interest entity. The Company further determined that the Company is the primary beneficiary of this variable interest entity and therefore consolidated this entity for financial reporting purposes. Upon consolidation, the Company recognized a lease termination fee of \$11,147 in March 2006.

6. STOCK TRANSACTIONS

During the three months ended March 31, 2006, stock options to purchase 12,500 shares of common stock were exercised at \$10.00 per share. Total proceeds to the Company were \$125. During the same period, one limited partner exchanged 50,000 O.P. units for 50,000 shares of the Company's common stock under the terms of the Exchange Rights Agreement among the Company and all limited partners of the operating partnerships resulting in a reclassification of \$589 from minority interest to paid-in-capital. Neither the Company nor the operating partnership received any proceeds from the issuance of the common stock in exchange for O.P. units.

7. DISCONTINUED OPERATIONS

Effective January 1, 2002, the Company adopted SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," which addresses

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financial accounting and reporting for the impairment and disposal of long lived assets. In general, income or loss attributable to the operations and sale of property and the operations related to property held for sale is classified as discontinued operations in the consolidated statements of operations. All periods presented in this report will likely require further reclassification in future periods if there are properties held for sale or property sales occur.

As of March 31, 2006, there were no properties under contract to be sold or otherwise disposed of which would qualify as assets held for sale or discontinued operations. During the first quarter of 2005, the Company sold two properties for a combined sales price of \$12,750. Condensed results of operations for these properties for the three months ended March 31, 2005 are as follows:

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MISSION WEST PROPERTIES, INC.
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED
 (dollars in thousands, except share, per share, O.P. units
 and per square footage amounts)
 (unaudited)

| | Three Months Ended March 31, 2006 | 2005 |
|---|---------------------------------------|-------|
| | ----- | ----- |
| | (dollars in thousands) (unaudited) | |
| Revenues | | |
| Rental revenue from real estate | - | \$ 14 |
| Tenant reimbursements | - | 1 |
| | ----- | ----- |
| Total revenues | - | 15 |
| | ----- | ----- |
| Expenses | | |
| Property operating, maintenance and real estate taxes | - | 22 |
| Depreciation | - | 33 |
| | ----- | ----- |
| Total expenses | - | 55 |
| | ----- | ----- |
| Loss from discontinued operations | - | (40) |
| Gain from disposal of discontinued operations | - | 63 |
| Minority interest in earnings attributable to discontinued operations | - | (18) |
| | ----- | ----- |
| Income from discontinued operations | - | \$ 5 |
| | ===== | ===== |

A deferred gain of approximately \$1,408 was recorded on one of the disposed properties in 2005. The gain was recognized as revenue based on the installment method of profit recognition because the purchaser of the property did not make a sufficiently large down payment under SFAS No. 66, "Accounting for Sales of Real Estate" ("SFAS No. 66"). SFAS No. 66

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establishes accounting standards for recognizing profit or loss on sales of real estate. Gain on the sale is recognized proportionately as the seller receives payments from the purchaser. Interest income is recognized on an accrual basis, when appropriate. The Company recorded a \$63 gain in the first quarter of 2005, and the balance of the expected gain was deferred until the Company received the remaining balance of the sales price from the purchaser.

8. NET INCOME PER SHARE

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

The computation for weighted average shares is detailed below:

| | Three Months Ended March 31, 2006 | 2005 |
|---|--------------------------------------|------------|
| | ----- | ----- |
| Weighted average shares outstanding (basic) | 18,455,897 | 18,110,524 |
| Incremental shares from assumed option exercise | 64,400 | 26,273 |
| | ----- | ----- |
| Weighted average shares outstanding (diluted) | 18,520,297 | 18,136,797 |
| | ===== | ===== |

Outstanding options to purchase 647,000 shares in 2006 and 2005 were excluded from the computation of diluted net income per share under the treasury stock method because the option exercise price was greater than the weighted average exercise price of the Company's common stock during the respective periods. The outstanding O.P. units, which are exchangeable at the unit holder's option, subject to certain conditions, for shares of common stock on a one-for-one basis have been excluded from the diluted net income per share calculation, as there would be no effect on the calculation after adding the minority interests' share of income back to net income. The total number of O.P. units outstanding at March 31, 2006 and 2005 was 86,038,095 and 86,334,695, respectively.

9. RELATED PARTY TRANSACTIONS

As of March 31, 2006, the Berg Group owned 77,490,528 O.P. units. The Berg Group's combined ownership of O.P. units and shares of common stock as of March 31, 2006 represented approximately 74% of the total equity interests, assuming conversion of the 86,038,095 O.P. units outstanding into the Company's common stock.

As of March 31, 2006, debt in the amount of \$9,955 was due the Berg Group under a mortgage note established on May 15, 2000 in connection with the acquisition of a 50% interest in Hellyer Avenue Limited Partnership, the obligor under the mortgage note. The mortgage note bears interest at 7.65% and is due in June 2010 with principal payments amortized over 20 years. Interest expense incurred in connection with the Berg Group line of credit, which was terminated in October 2005, and mortgage note was \$192 and \$307 for the three months ended March 31, 2006 and 2005, respectively.

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MISSION WEST PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED
(dollars in thousands, except share, per share, O.P. units
and per square footage amounts)
(unaudited)

During the first three months of 2006 and 2005, Carl E. Berg or entities controlled by Mr. Berg held financial interests in several companies that lease space from the operating partnerships, which include three companies in which Mr. Berg has a greater than 10% ownership interest. These related tenants occupy approximately 48,000 square feet and contributed \$132 and \$217 in rental revenue during the three months ended March 31, 2006 and 2005, respectively. Under the Company's charter, bylaws and agreements with the Berg Group, the individual members of the Berg Group are prohibited from acquiring or holding shares of the Company's common stock if such acquisition would result in their beneficial ownership percentage of the Company's common stock causing the Company to violate any REIT qualification requirement.

In March 2006, the Company and Fujitsu Limited, or Fujitsu, agreed to the termination of a lease for one building consisting of approximately 125,000 rentable square feet. Fujitsu is responsible for repairing damage to the building and with the Company's Independent Directors Committee approval has hired Berg & Berg Enterprises, LLC to perform the restoration work for a total of approximately \$4,500.

The Berg Group has an approximately \$2,500 commitment to complete certain tenant improvements in connection with the Company's 2002 acquisition of 5345 Hellyer Avenue in San Jose. The Company recorded this portion of the purchase price paid to the Berg Group as an "other asset" on its consolidated balance sheets. The Berg Group plans to satisfy this commitment to complete certain tenant improvements when requested by the Company following the approval of the Independent Directors Committee of the Company's Board of Directors (the "Independent Directors Committee").

The Berg Group has an approximately \$7,500 commitment to complete an approximately 75,000 to 90,000 square foot building in connection with the Company's 2001 acquisition of 245 Caspian in Sunnyvale which is comprised of approximately three acres of unimproved land. The Company recorded this portion of the purchase price paid to the Berg Group as an "other asset" on its consolidated balance sheets. The Berg Group plans to satisfy this commitment to construct a building when requested by the Company following the approval of the Independent Directors Committee.

The Company currently leases office space owned by Berg & Berg Enterprises, Inc., an affiliate of Carl E. Berg and Clyde J. Berg. Rental amounts and overhead reimbursements paid to Berg & Berg Enterprises, Inc. were \$23 for each of the three-month periods ended March 31, 2006 and 2005.

10. COMMITMENTS AND CONTINGENCIES

Neither the operating partnerships, the Company's properties nor the Company are subject to any material litigation nor, to the Company's knowledge, is any material litigation threatened against the operating partnerships, the properties or the Company. From time to time, the Company is engaged in legal proceedings arising in the ordinary course of business. The Company does not expect any of such proceedings to have a material adverse effect on its cash flows, financial condition or results of operations. The Company is currently involved in the following legal proceedings, and does not believe the ultimate outcome of any of these proceedings will have a material adverse effect on its financial condition

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or operating results.

Republic Properties Corporation ("RPC") v. Mission West Properties, L.P. ("MWP"), in the Circuit Court of Maryland for Baltimore City Case No. 24-C-00-005675. RPC is a former partner with Mission West Properties, L.P. in the Hellyer Avenue Limited Partnership ("Hellyer LP"). In April 2004, the Circuit Court for Baltimore City, Maryland issued a Memorandum Opinion in the case and awarded damages of approximately \$934 to the RPC plaintiffs, which represented a liability of the Company or MWP. The Company has a receivable from a Berg Group affiliate for the amount of distributions it received as the successor to RPC's interest in the Hellyer LP, which exceeds the amount of the damages awarded to the RPC parties and would be used to pay those damages in the event the decision of the Circuit Court is upheld ultimately. The Company has never accounted for the 50% interest in Hellyer LP that is claimed by RPC as an asset of the Company. In February 2001, the Company filed a suit against RPC in Superior Court of the State of California for the County of Santa Clara Case No. CV 796249 which was stayed pending resolution of the Maryland case. In March 2005, the Company voluntarily dismissed its California suit. On March 1, 2005, the Maryland Appeals Court ruled in favor of Mission West Properties, L.P., finding that the Circuit Court of Maryland lacked personal jurisdiction over MWP. In April 2005, the decision of the Maryland Appeals Court became final, and the Company obtained a court order for the release of a \$1,551 bond, which it posted to remove an attachment order issued to RPC. In April 2005, RPC submitted a motion to the Superior Court of the State of California effectively asking the court to prevent MWP from dismissing the previously dismissed California suit. In July 2005, the Maryland Supreme Court agreed to hear an appeal filed by RPC. In April 2006 the Maryland Supreme Court upheld an earlier Maryland Appeals Court ruling in favor of MWP, finding that the Circuit Court of Maryland could not assert personal jurisdiction in the RPC suit. All litigation in the Maryland portion of this dispute over the Hellyer Avenue limited partnership is now concluded in our favor. The lawsuit in the Santa Clara County, California Superior Court is still unresolved.

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MISSION WEST PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED
(dollars in thousands, except share, per share, O.P. units
and per square footage amounts)
(unaudited)

In January 2004, the Global Crossing Estate Representative, for itself and the Liquidating Trustee of the Global Crossing Liquidating Trust v. Mission West Properties filed an action in United States Bankruptcy Court Southern District of New York Case No. 02-40188 (REG) asserting that payments of approximately \$815 made in the ordinary course of business within 90 days of the Global Crossing bankruptcy filing were preference payments. The Company has engaged legal counsel to defend itself in this claim and intend to vigorously contest the matter. On February 9, 2005, the Court held a hearing to consider the objection filed with respect to Mission West Properties' claim. In April 2005, the Company filed a motion for summary judgment in the United States Bankruptcy Court Southern District of New York requesting the Court to dismiss the preference claim. The motion for summary judgment was denied. Discovery continues by both parties and no trial date has been set.

GUARANTEES AND INDEMNITIES

Under its articles of incorporation and bylaws, the Company has agreed to indemnify its officers and directors for certain events or occurrences arising as a result of the officer or director's serving in such capacity.

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The maximum potential amount of future payments the Company could be required to make under these indemnification agreements is unlimited. The Company believes the estimated fair value of these indemnification agreements is minimal and has recorded no liabilities for these agreements as of March 31, 2006.

The Company also enters into indemnification provisions under its agreements with other companies in the ordinary course of business, typically with lenders, joint venture partners, contractors, and tenants. Under these provisions the Company typically agrees to indemnify and hold harmless the indemnified party for losses suffered or incurred by the indemnified party as a result of certain kinds of activities or inactions of the Company. These indemnification provisions generally survive termination of the underlying agreement. The maximum potential amount of future payments the Company could be required to make under these indemnification provisions is unlimited. To date, the Company has not incurred material costs to defend lawsuits or settle claims related to these indemnification agreements. As a result, the Company believes the estimated fair value of these agreements is minimal. Accordingly, the Company has recorded no liabilities for these agreements as of March 31, 2006.

SEISMIC ACTIVITY

The Company's properties are located in an active seismic area of Silicon Valley. Insurance policies currently maintained by the Company do not cover seismic activity, although they do cover losses from fires after an earthquake.

ENVIRONMENTAL ISSUES

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

BERG LAND HOLDINGS OPTION AGREEMENT

In April 2005, the Berg Group disclosed the receipt of an offer from an unrelated party to purchase a portion of the Piercy & Hellyer land comprised of approximately 10 acres in San Jose, California that is subject to the Berg Land Holdings Option Agreement with the Company. The prospective purchaser has disclosed its intention to develop "for sale" industrial type buildings. In light of the overcapacity in the Silicon Valley R&D properties market and the Company's current inventory of available buildings for lease in this submarket, the Independent Directors Committee, which is responsible for reviewing, evaluating and authorizing action with respect to any transaction between us and any member of the Berg Group, has authorized removal of this approximately 10-acre parcel of land from the scope of the Berg Land Holdings Option Agreement, subject to the completion of the sale to the unrelated party. In making this determination, the Independent Directors Committee considered a number of factors, including risks and other potentially adverse consequences that could be associated with acquiring undeveloped land for future development. In the event this parcel of land is not sold to this prospective purchaser, the parcel would not be deemed to be removed from the scope of the Berg Land Holdings Option Agreement and would remain eligible for potential

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future acquisition by the Company under the Berg Land Holdings Option Agreement.

In light of the overcapacity in the Silicon Valley R&D properties market, the Berg Group currently is seeking local government approval of a proposed rezoning of the 160-acre Evergreen site to permit residential development on a substantial portion of the site. The Independent Directors Committee, which is responsible for reviewing, evaluating and authorizing action with respect to any transaction between the Company and any member of the Berg Group, authorized removal of the Evergreen site from the scope of the Berg Land Holdings Option Agreement, subject to the completion of the rezoning of the 160-acre Evergreen site, or portion thereof, for residential development. In making this determination, the Independent Directors Committee considered a number of factors, including risks and other potentially adverse consequences that could be associated with large scale residential development

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MISSION WEST PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED
(dollars in thousands, except share, per share, O.P. units
and per square footage amounts)
(unaudited)

activities. Any portion of the Evergreen site that is not rezoned as residential property is not deemed to be removed from the scope of the Berg Land Holdings Option Agreement and would remain eligible for potential future acquisition by the Company under the Berg Land Holdings Option Agreement.

11. SUBSEQUENT EVENTS

On April 6, 2006, the Company paid dividends of \$0.16 per share of common stock to all common stockholders of record as of March 31, 2006. On the same date, the operating partnerships paid a distribution of \$0.16 per O.P. unit to all holders of O.P. units. Aggregate dividends and distributions amounted to approximately \$16,728.

In May 2006, one limited partner exchanged 789,796 O.P. units for 789,796 shares of the Company's common stock under the terms of the Exchange Rights Agreement among the Company and all limited partners of the operating partnerships. Neither the Company nor the operating partnership received any proceeds from the issuance of the common stock in exchange for O.P. units.

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

This Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the accompanying consolidated financial statements and notes thereto contained herein and our consolidated financial statements and notes thereto contained in our Annual Report on Form 10-K as of and for the year ended December 31, 2005. The results for the three months ended March 31, 2006 are not necessarily indicative of the results to be expected for the entire fiscal year ending December 31, 2006. The following discussion includes forward-looking statements, including but not limited to, statements with respect to our future financial performance, operating results, plans and objectives. Actual results may differ materially from those currently

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anticipated depending upon a variety of factors, including those described under the sub-heading, "Forward-Looking Information."

FORWARD-LOOKING INFORMATION

This quarterly report contains forward-looking statements within the meaning of the federal securities laws. We intend such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Reform Act of 1995, and are including this statement for purposes of complying with these safe harbor provisions. Forward-looking statements, which are based on certain assumptions and describe future plans, strategies and expectations of the Company, are generally identifiable by use of the words "believe," "expect," "intend," "anticipate," "estimate," "project" or similar expressions. Additionally, all disclosures under Part I, Item 3 constitute forward-looking statements. Our ability to predict results or the actual effect of future plans or strategies is inherently uncertain.

Factors that could have a material adverse effect on our operations and future prospects include, but are not limited to, the following:

- economic conditions generally and the real estate market specifically,
- legislative or regulatory provisions (including changes to laws governing the taxation of REITs),
- availability of capital,
- interest rates,
- competition,
- supply of and demand for R&D, office and industrial properties in our current and proposed market areas,
- tenant defaults and bankruptcies,
- lease term expirations and renewals, and
- changes in general accounting principles, policies and guidelines applicable to REITs.

In addition, the actual timing of development, construction, and leasing on any projects that we believe we may acquire in the future under the Berg Land Holdings Option Agreement is presently unknown, and reliance should not be placed on estimates concerning these projects. These risks and uncertainties, together with the other risks described from time to time in our reports and other documents filed with the Securities and Exchange Commission, should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements.

OVERVIEW

We acquire, market, lease, and manage R&D/office properties, primarily located in the Silicon Valley portion of the San Francisco Bay Area. As of March 31, 2006, we owned and managed 109 properties totaling approximately 7.9 million rentable square feet through four limited partnerships, or operating partnerships, for which we are the sole general partner. This class of property is designed for research and development and office uses and, in some cases, includes space for light manufacturing operations with loading docks. We believe that we have one of the largest portfolios of R&D/office properties in the Silicon Valley. As of March 31, 2006, the four tenants who each leased in excess of 300,000 rentable square feet from us were Microsoft Corporation, NEC Electronics America, Inc. (a subsidiary of NEC Electronics Corporation), Ciena Corporation and Apple Computer, Inc. For federal income tax purposes, we have operated as a self-managed, self-administered and fully integrated real estate investment trust ("REIT") since fiscal 1999.

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

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- working with the Berg Group to take advantage of their abilities and resources to pursue development opportunities which we have an option to acquire, on pre-negotiated terms, upon completion and leasing;
- capitalizing on opportunistic acquisitions from third parties of high-quality R&D/office properties that provide attractive initial yields and significant potential for growth in cash-flow;
- focusing on general purpose, single-tenant Silicon Valley R&D/office properties for information technology companies in order to maintain low operating costs, reduce tenant turnover and capitalize on our relationships with these companies and our extensive knowledge of their real estate needs; and

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- maintaining prudent financial management principles that emphasize current cash flow while building long-term value, the acquisition of pre-leased properties to reduce development and leasing risks and the maintenance of sufficient liquidity to acquire and finance properties on desirable terms.

CURRENT ECONOMIC ENVIRONMENT

All of our properties are located in the Northern California area known as Silicon Valley, which generally consists of portions of Santa Clara County, Southwestern Alameda County, Southeastern San Mateo County and Eastern Santa Cruz County. The Silicon Valley R&D property market has historically fluctuated with the local economy. The Silicon Valley economy and business activity have slowed markedly since 2001 after fast-paced growth in 1999 and 2000. According to a recent report by NAI BT Commercial Real Estate, the vacancy rate for Silicon Valley R&D property was approximately 19.6% in late 2005 and 20.1% at the end of the first quarter of 2006. Total vacant R&D square footage in Silicon Valley at the end of the first quarter of 2006 amounted to 31.0 million square feet, of which 22.4%, or 7.0 million square feet, was being offered under subleases. Total positive net absorption (which is the computation of gross square footage leased less gross new square footage vacated for the period presented) in 2005 amounted to approximately 3.6 million square feet. During the first three months of 2006, there was total negative net absorption of approximately (0.97) million square feet. Average asking market rent per square foot at the end of the first quarter of 2006 was \$0.89 compared to \$0.88 in late 2005, although individual properties within any particular submarket presently may be leased above or below the current average asking market rental rates within that submarket. The Silicon Valley R&D property market has been characterized by a substantial number of submarkets, with rent and vacancy rates varying by submarket and location within each submarket.

Our occupancy rate at March 31, 2006 was 67.3% compared to 67.7% at March 31, 2005. We believe that our occupancy rate could decline further going forward if key tenants seek the protection of bankruptcy laws, consolidate operations or discontinue operations. In addition, leases with respect to approximately 245,000 rentable square feet are expiring prior to the end of 2006. The properties subject to these leases may take anywhere from 24 to 36 months or longer to re-lease. We believe that the average 2006 renewal rental rates for our properties will be approximately equal to, or perhaps below, current market rents, but we cannot give any assurance that leases will be renewed or that available space will be re-leased at rental rates equal to or above the current quoted market rates.

Despite our strategic focus on single tenant properties and leases, in order to meet market conditions, we have been, and expect to continue leasing less than the entire premises of some of our R&D properties to a single tenant from time to time. Leasing our R&D properties, which generally have been built for single

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tenant occupancy, to multiple tenants can increase our leasing costs and operating expenses and reduce the profitability of our leasing activities.

If we are unable to lease a significant portion of any vacant space or space subject to expiring leases; if we experience significant tenant defaults as a result of the current economic downturn; if we are not able to lease space at or above current market rates; if we restructure existing leases and lower existing rents in order to retain tenants for an extended term; or if we increase our lease costs and operating expenses substantially to accommodate multiple tenants in our R&D properties, our results of operations and cash flows will be adversely affected. Furthermore, in this event it is probable that our board of directors will reduce the quarterly dividend on the common stock and the outstanding O.P. units. Our operating results and ability to pay dividends at current levels remain subject to a number of material risks, as indicated under the caption "Forward-Looking Information" above and in the section entitled "Risk Factors" in our most recent annual report on Form 10-K.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

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

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

BUSINESS COMBINATIONS. Statement of Financial Accounting Standards ("SFAS") No. 141, "Business Combinations" ("SFAS No. 141"), was effective July 1, 2001. The acquisition costs of each property acquired prior to July 1, 2001 were allocated only to building, land and leasing commissions with building depreciation being computed based on an estimated weighted average composite useful life of 40 years and leasing commission amortization being computed over the term of the lease. Acquisitions of properties made subsequent to the effective date of SFAS No. 141 are based on an allocation of the acquisition cost to land, building, tenant improvements, and intangibles for at market, including lease origination and lease up period costs, and above and below market in place leases, and the determination of their useful lives are guided by a combination of SFAS No. 141 and management's estimates. If we do not appropriately allocate these

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components or we incorrectly estimate the useful lives of these components, our computation of depreciation and amortization expense may not appropriately reflect the actual impact of these costs over future periods, which will affect net income.

IMPAIRMENT OF LONG-LIVED ASSETS. We review real estate assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable in accordance with SFAS No. 144, "Accounting for

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the Impairment and Disposal of Long-Lived Assets" ("SFAS No. 144"). If the carrying amount of the asset exceeds its estimated undiscounted net cash flow, before interest, we will recognize an impairment loss equal to the difference between its carrying amount and its estimated fair value. If impairment is recognized, the reduced carrying amount of the asset will be accounted for as its new cost. For a depreciable asset, the new cost will be depreciated over the asset's remaining useful life. Generally, fair values are estimated using discounted cash flow, replacement cost or market comparison analyses. The process of evaluating for impairment requires estimates as to future events and conditions, which are subject to varying market factors, such as the vacancy rates, future rental rates, lease periods, deferred maintenance and operating costs for R&D facilities in the Silicon Valley area and related submarkets. Therefore, it is reasonably possible that a change in estimate resulting from judgments as to future events could occur which would affect the recorded amounts of the property.

ALLOWANCE FOR DOUBTFUL ACCOUNTS AND DEFERRED RENT. We must estimate the uncollectibility of our accounts receivable based on the evaluation of our tenants' financial position, analyses of accounts receivable and current economic trends. We also make estimates for reserves against our deferred rent receivable for existing tenants with the potential of early termination, bankruptcy or ceasing operations. We charge or credit rental income for increases or decreases to our deferred rent reserves. Our estimates are based on our review of tenants' payment histories, the remaining lease term, whether or not the tenant is currently occupying our building, publicly available financial information and such additional information about their financial condition as tenants provide to us. The information available to us might lead us to overstate or understate these reserve amounts. The use of different estimates or assumptions could produce different results. Moreover, actual future collections of accounts receivable or reductions in future reported rental income due to tenant bankruptcies or other business failures could differ materially from our estimates.

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

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

FAIR VALUE OF FINANCIAL INSTRUMENTS. Our financial instruments include cash and cash equivalents, accounts receivable, accounts payable, and debt. Considerable judgment is required in interpreting market data to develop estimates of fair value. Our estimates of fair value are not necessarily indicative of the amounts that we could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts. Cash and cash equivalents, accounts receivable, and accounts payable are carried at amounts that approximate their fair values due to their short-term maturities. The carrying amounts of our variable rate debt approximate fair value since the interest rates on these instruments are equivalent to rates currently offered to us. For fixed rate debt, we estimate

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fair value by using discounted cash flow analyses based on borrowing rates for similar kinds of borrowing arrangements.

STOCK-BASED COMPENSATION. In December 2004, the FASB issued SFAS No. 123R, "Share-Based Payment" ("SFAS No. 123R"), which addresses the accounting for employee and director stock options. Statement 123R requires that the cost of all employee and director stock options, as well as other equity-based compensation arrangements, be reflected in the financial statements based on the estimated fair value of the awards. SFAS No. 123R is an amendment to SFAS No. 123 and supersedes APB Opinion 25 ("APB 25"). SFAS No. 123R is applicable to any award that is settled or measured in stock, including stock options, restricted stock, stock appreciation rights, stock units, and employee stock purchase plans. We have adopted the requirements of SFAS No. 123R effective January 1, 2006 using the modified prospective method of transition. Accordingly, prior periods have not been restated. The adoption of this standard did not have a material effect on our consolidated statements of operations or financial position. Compensation cost under SFAS No. 123R may differ due to different assumptions and treatment of forfeitures.

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

Rental revenue is affected if existing tenants terminate or amend their leases. We try to identify tenants who may be likely to declare bankruptcy, cease operations or are likely to seek a negotiated settlement of their obligation. By anticipating these events in advance, we expect to take steps to minimize their impact on our reported results of operations through lease renegotiations, reserves against deferred

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rent, and other appropriate measures. Our judgments and estimations about tenants' capacity to continue to meet their lease obligations will affect the rental revenue recognized. Material differences may result in the amount and timing of our rental revenue for any period if we made different judgments or estimations.

SFAS No. 66, "Accounting for Sales of Real Estate" ("SFAS No. 66"), establishes accounting standards for recognizing profit or loss on sales of real estate. The gain on the sale is only recognized proportionately as the seller receives payments from the purchaser. Interest income is recognized on an accrual basis, when appropriate.

Lease termination fees are recognized as other income when there is a signed termination letter agreement, all of the conditions of the agreement have been met, and when the tenant no longer has the right to occupy the property. These fees are paid by tenants who want to terminate their lease obligations before the end of the contractual term of the lease. We cannot predict or forecast the timing or amounts of future lease termination fees.

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

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

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- collectibility is reasonably assured.

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

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RESULTS OF OPERATIONS

COMPARISON OF THE THREE MONTHS ENDED MARCH 31, 2006 TO THE THREE MONTHS ENDED MARCH 31, 2005

As of March 31, 2006, through our controlling interests in the operating partnerships, we owned 109 properties totaling approximately 7.9 million rentable square feet compared to 108 properties totaling approximately 8.0 million rentable square feet owned by us as of March 31, 2005. This represents a net decrease of approximately 1% in total rentable square footage, as we acquired one property consisting of approximately 95,700 rentable square feet and disposed of one property consisting of approximately 239,000 rentable square feet since the first quarter of 2005.

RENTAL REVENUE FROM REAL ESTATE FROM CONTINUING OPERATIONS

For the quarter ended March 31, 2006, rental revenue from real estate decreased by approximately (\$1.9) million, or 7.4%, from \$26.2 million for the three months ended March 31, 2005 to \$24.3 million for the same period of 2006. Rental revenue includes approximately (\$0.5) million in amortization for the three months ended March 31, 2006 and 2005 for the amortization of an above-market lease intangible asset pursuant to SFAS No. 141. The decline in rental revenue was primarily a result of lower rental rates on new leases and renewals and the loss of several tenants due to bankruptcy, relocation or cessation of their operations since March 31, 2005, all of which resulted from current adverse market conditions. Our occupancy rate at March 31, 2006 was approximately 67.3%, compared to approximately 67.7% at March 31, 2005. Due to an over supply of R&D properties and competition from other landlords in the Silicon Valley, our occupancy rate may drop further if the 245,000 rentable square feet scheduled to expire during the remainder of 2006 is not renewed or re-leased.

EQUITY IN EARNINGS FROM UNCONSOLIDATED JOINT VENTURE

As of March 31, 2006, we had investments in four R&D buildings, totaling 593,000 rentable square feet, through an unconsolidated joint venture, TBI-MSW, in which we acquired a 50% interest in January 2003 from the Berg Group under the Berg Land Holdings Option Agreement. We have a non-controlling limited partnership interest in this joint venture, which we account for using the equity method of accounting. For the three months ended March 31, 2006, we recorded equity in earnings from the unconsolidated joint venture of approximately \$0.33 million compared to equity in loss of (\$6,000) for the same period in 2005. Our equity in earnings from this unconsolidated joint venture increased in the first quarter of 2006 resulted from the write-offs of leasing commission and tenant improvements in the first quarter of 2005 for a tenant that terminated its lease agreement in December 2004 that did not recur in 2006. The occupancy rate for the properties owned by this joint venture at March 31, 2006 and 2005 was approximately 78.7%.

LEASE TERMINATION INCOME FROM CONTINUING OPERATIONS

Lease termination fees for the three months ended March 31, 2006 were approximately \$16.1 million. These fees were paid by four tenants who terminated their lease obligations before the end of the contractual term of the lease.

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There was no lease termination income in the first quarter of 2005. We do not consider those transactions to be recurring items.

OTHER INCOME FROM CONTINUING OPERATIONS

Other income of approximately \$0.7 million for the three months ended March 31, 2006 included approximately \$0.4 million from interest income and \$0.3 million from management fee income. Other income for the three months ended March 31, 2005 consisted primarily of management fee income and miscellaneous income.

EXPENSES FROM CONTINUING OPERATIONS

Property operating expenses and real estate taxes during the first quarter of 2006 decreased by approximately (\$0.2) million, or 4.3%, from \$4.9 million to \$4.7 million for the three months ended March 31, 2005 and 2006, respectively, due primarily to property tax refunds totaling approximately \$0.2 million in the first quarter of 2006 and two R&D property dispositions in the first quarter of 2005. Tenant reimbursements decreased by approximately (\$0.3) million, or 8.8%, from \$3.6 million for the three months ended March 31, 2005 to \$3.3 million for the three months ended March 31, 2006 due to lower occupancy. Certain expenses such as property insurance, real estate taxes, and other fixed operating expenses are not recoverable from vacant properties. General and administrative expenses remained relatively the same for the three months ended March 31, 2006 and 2005.

Depreciation and amortization expense of real estate decreased by approximately (\$0.1) million, or 1.7%, from \$5.6 million to \$5.5 million for the three months ended March 31, 2005 and 2006, respectively. The decrease was attributable primarily to the disposition of two R&D properties during the first quarter of 2005.

Interest expense increased by approximately \$0.6 million, or 12.2%, from \$4.6 million for the three months ended March 31, 2005 to \$5.2 million for the three months ended March 31, 2006. Interest expense (related parties) decreased by approximately (\$0.1) million, or 37.5%, from \$0.3 million for the three months ended March 31, 2005 to \$0.2 million for the three months ended March 31, 2006 due to the termination of the Berg Group line of credit in October 2005. Total debt outstanding, including amounts due related parties, increased by approximately \$23.4 million, or 6.9%, from \$341.6 million as of March 31, 2005 to \$365.0 million as of March 31, 2006. Overall interest expense, including amounts paid to related parties, for the quarter ended March 31, 2006 increased by approximately \$0.5 million compared to the same quarter a year ago primarily due to two new fixed rate secured mortgage loans of \$25.8 million and \$125 million from Allianz Life Insurance Company obtained in April 2005 and July 2005, respectively.

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INCOME FROM DISCONTINUED OPERATIONS

The following table depicts the amounts of income from discontinued operations for the three months ended March 31, 2005.

| | Three Months Ended March 31, 2006 | 2005 |
|---|--------------------------------------|-------|
| | ----- | ----- |
| | (dollars in thousands) | |
| | (unaudited) | |
| Gain from disposal of discontinued operations | - | \$ 63 |
| Loss attributable to discontinued operations | - | (40) |
| Minority interest in earnings attributable to | | |

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| | | |
|-------------------------------------|---|------|
| discontinued operations | - | (18) |
| | - | \$ 5 |
| Income from discontinued operations | - | \$ 5 |
| | - | \$ 5 |

In accordance with our adoption of SFAS No. 144, in the first quarter of 2005 we sold and classified as discontinued operations two properties consisting of 103,350 rentable square feet and recorded a gain of \$63,000, of which \$14,000 and \$49,000 were attributable to common stockholders and minority interests, respectively.

The income to common stockholders and minority interests attributable to discontinued operations from these two properties for the three months ended March 31, 2005 was approximately \$5,000 and \$18,000, respectively.

NET INCOME AVAILABLE TO COMMON STOCKHOLDERS AND NET INCOME AVAILABLE TO MINORITY INTERESTS

Minority interest in net income has been calculated by taking the net income of the operating partnerships (on a stand-alone basis) multiplied by the respective minority interest ownership percentage. Minority interest represents the ownership interest of all limited partners in the operating partnerships taken as a whole, which was approximately 82% and 83% as of March 31, 2006 and 2005, respectively.

Net income available to common stockholders increased by approximately \$2.7 million, or 114.0%, from \$2.4 million for the three months ended March 31, 2005 to \$5.1 million for the same period in 2006. The minority interest portion of income increased by approximately \$11.7 million, or 100%, from \$11.7 million for the three months ended March 31, 2005 to \$23.4 million for the three months ended March 31, 2006. The increase in net income for both common stockholders and minority interests was primarily due to the realization of lease termination fees and lower operating expenses and property taxes in 2006, partially offset with increases in interest expense.

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CHANGES IN FINANCIAL CONDITION

The most significant changes in our financial condition during the three months ended March 31, 2006 resulted from the acquisition of one R&D property. In addition, total stockholders' equity increased from the issuance of common stock for the exchange of O.P. units and stock option exercises.

At March 31, 2006, total investments in properties had a net increase of approximately \$13.5 million from December 31, 2005 due to one R&D property acquisition. During the first three months of 2006, we acquired one R&D property consisting approximately 95,700 rentable square feet located in the Silicon Valley. The purchase price for this property was approximately \$13.5 million.

Total stockholders' equity, net, increased by approximately \$3.0 million from December 31, 2005 as we obtained additional capital from the issuance of 50,000 shares of our common stock for the exchange of O.P. units and 12,500 shares of our common stock from stock option exercises and incurred a surplus of approximately \$2.2 million due to the realization of higher lease termination fees for the period. During the first three months of 2006, one limited partner exchanged 50,000 O.P. units for 50,000 shares of our common stock under the Exchange Rights Agreement among us and the limited partners in the operating partnerships. In addition, stock options to purchase 12,500 shares of common stock were exercised. The newly issued shares increased additional paid in

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capital by approximately \$0.7 million.

LIQUIDITY AND CAPITAL RESOURCES

We expect a continued decline in operating cash flows from our operating property portfolio in 2006 as compared to 2005. The reduction in cash flows reflects the overall reduced demand for R&D properties, lower rental rates for new and renewed leases, and an increase in vacant properties in 2006. In addition, if we are unable to lease a significant portion of the approximately 245,000 rentable square feet scheduled to expire during the remainder of 2006 or an equivalent amount of our currently available space of approximately 2.9 million rentable square feet, our operating cash flows may be affected adversely. With the expectation of lower rental revenues for the remainder of 2006, we expect the properties' net operating income to continue to show year over year declines when compared to 2005. As noted above, we expect cash flows from operating activities to continue to show declines primarily driven by the general downturn in the Silicon Valley's economy in recent years, the softening of the Company's market specifically, and the expected weaker performance of our properties. We are also subject to risks of decreased occupancy through tenant defaults and bankruptcies and potential reduction in rental rates upon renewal of properties, which would result in reduced cash flow from operations. It is reasonably likely that vacancy rates may continue to increase and effective rental rates on new and renewed leases may continue to decrease.

We expect our principal source of liquidity for distributions to stockholders and O.P. unit holders, debt service, leasing commissions and recurring capital expenditures to come from cash provided by operations and/or the borrowings under the line of credit with Cupertino National Bank ("CNB"). We expect these sources of liquidity to be adequate to meet projected distributions to stockholders and other presently anticipated liquidity requirements in 2006. We expect to meet our long-term liquidity requirements for the funding of property development, property acquisitions and other material non-recurring capital improvements through cash and investments, long-term secured and unsecured indebtedness and the issuance of additional equity securities by us. We have the ability to meet short-term obligations or other liquidity needs based on a line of credit with CNB. We expect our total interest expense to increase through new financing activities. In the remainder of 2006, we will be obligated to make payments totaling approximately \$7.8 million of debt principal under mortgage notes without regard to any debt refinancing or new debt obligations that we might incur, or optional payments of debt principal.

Cash and cash equivalents increased by approximately \$8.5 million from \$31.4 million as of December 31, 2005 to \$39.9 million as of March 31, 2006 primarily from cash flow from operations and excess remaining restricted cash from a 1031 tax-deferred exchange transaction.

Restricted cash totaled \$12.7 million as of March 31, 2006. Of this amount, \$11.1 million represents a balance we consolidated due to our adoption of FIN 46R, "Consolidation of Variable Interest Entities" (see Note 5). The remaining \$1.6 million represents a bond we posted in the Republic Properties Corporation v. Mission West Properties, L.P. litigation (see Note 10). We do not possess or control these funds or have any rights to receive them except as provided in the applicable agreements. Therefore, restricted cash is not available for distribution to stockholders.

DISTRIBUTIONS

On April 6, 2005, we paid dividends of \$0.16 per share of common stock to all common stockholders of record as of March 31, 2006. On the same date, the operating partnerships paid a distribution of \$0.16 per O.P. unit to all holders of O.P. units. Aggregate dividends and distributions amounted to approximately \$16.7 million. For the remainder of 2006, we expect to maintain our current quarterly dividend payment rate to common shareholders and O.P. unit holders of

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\$0.16 per share. However, distributions are declared at the discretion of our Board of Directors and are subject to actual cash available for distribution, our financial condition, capital requirements and such other factors, as our Board of Directors deems relevant.

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DEBT

At March 31, 2006, we had total indebtedness of \$365.0 million, including \$355.0 million of fixed rate mortgage debt and \$10.0 million under the Berg Group mortgage note (related parties), as detailed in the table below. The CNB loan contains certain financial loan and reporting covenants as defined in the loan agreements. As of March 31, 2006, we were in compliance with these loan covenants.

CONTRACTUAL OBLIGATIONS

The following table identifies our contractual obligations as of March 31, 2006 that will impact our liquidity and cash flow in future periods:

| | 2006 | 2007 | 2008 | 2009 | 2010 |
|--------------------------------|------------------------|----------|-----------|---------|----------|
| | ----- | | | | |
| | (dollars in thousands) | | | | |
| Long-Term Debt Obligations(1) | \$7,847 | \$11,029 | \$121,605 | \$9,580 | \$10,125 |
| Operating Lease Obligations(2) | 68 | 23 | - | - | - |
| | ----- | | | | |
| Total | \$7,915 | \$11,052 | \$121,605 | \$9,580 | \$10,125 |
| | ===== | | | | |

(1) Our long-term debt obligations are set forth in detail in the schedule below.

(2) Our operating lease obligations relate to a lease of our corporate office facility from a related party.

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The following table sets forth information regarding debt outstanding as of March 31, 2006:

| Debt Description | Collateral Properties | |
|---|--|-------------|
| | | ----- |
| | | (dollars in |
| Line of Credit: | | |
| Cupertino National Bank | Not Applicable | ----- |
| Mortgage Notes Payable (related parties): | 5300 & 5350 Hellyer Avenue, San Jose, CA | \$ 9 |
| Mortgage Notes Payable (1): | | ----- |
| Prudential Insurance Company of America (2) | 10300 Bubb Road, Cupertino, CA | 116 |

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| | | |
|--|---|-------|
| | 10500 N. De Anza Boulevard, Cupertino, CA | |
| | 4050 Starboard Drive, Fremont, CA | |
| | 45700 Northport Loop, Fremont, CA | |
| | 45738 Northport Loop, Fremont, CA | |
| | 450 National Avenue, Mountain View, CA | |
| | 6311 San Ignacio Avenue, San Jose, CA | |
| | 6321 San Ignacio Avenue, San Jose, CA | |
| | 6325 San Ignacio Avenue, San Jose, CA | |
| | 6331 San Ignacio Avenue, San Jose, CA | |
| | 6341 San Ignacio Avenue, San Jose, CA | |
| | 6351 San Ignacio Avenue, San Jose, CA | |
| | 3236 Scott Boulevard, Santa Clara, CA | |
| | 3560 Bassett Street, Santa Clara, CA | |
| | 3570 Bassett Street, Santa Clara, CA | |
| | 3580 Bassett Street, Santa Clara, CA | |
| | 1135 Kern Avenue, Sunnyvale, CA | |
| | 1212 Bordeaux Lane, Sunnyvale, CA | |
| | 1230 E. Arques, Sunnyvale, CA | |
| | 1250 E. Arques, Sunnyvale, CA | |
| | 1170 Morse Avenue, Sunnyvale, CA | |
| | 1600 Memorex Drive, Santa Clara, CA | |
| | 1688 Richard Avenue, Santa Clara, CA | |
| | 1700 Richard Avenue, Santa Clara, CA | |
| | 3540 Bassett Street, Santa Clara, CA | |
| | 3542 Bassett Street, Santa Clara, CA | |
| | 3544 Bassett Street, Santa Clara, CA | |
| | 3550 Bassett Street, Santa Clara, CA | |
| Northwestern Mutual Life Insurance Company (4) | 1750 Automation Parkway, San Jose, CA | 90 |
| | 1756 Automation Parkway, San Jose, CA | |
| | 1762 Automation Parkway, San Jose, CA | |
| | 6320 San Ignacio Avenue, San Jose, CA | |
| | 6540-6541 Via Del Oro, San Jose, CA | |
| | 6385-6387 San Ignacio Avenue, San Jose, CA | |
| | 2251 Lawson Lane, Santa Clara, CA | |
| | 1325 McCandless Drive, Milpitas, CA | |
| | 1650-1690 McCandless Drive, Milpitas, CA | |
| | 20605-20705 Valley Green Drive, Cupertino, CA | |
| Allianz Life Insurance Co. (Allianz Loan I) (5) | 5900 Optical Court, San Jose, CA | 25 |
| Allianz Life Insurance Co. (Allianz Loan II) (5) | 5325-5345 Hellyer Avenue, San Jose, CA | 122 |
| | 1768 Automation Parkway, San Jose, CA | |
| | 2880 Scott Boulevard, Santa Clara, CA | |
| | 2890 Scott Boulevard, Santa Clara, CA | |
| | 2800 Scott Boulevard, Santa Clara, CA | |
| | 20400 Mariani Avenue, Cupertino, CA | |
| | 10450-10460 Bubb Road, Cupertino, CA | |
| | | ----- |
| | | 355 |
| | | ----- |
| TOTAL | | \$364 |
| | | ===== |

- (1) Mortgage notes payable generally require monthly installments of interest and principal ranging from \$177,000 to \$840,000 over various terms extending through the year 2025. The weighted average interest rate of mortgage notes payable was 5.84% at March 31, 2006.
- (2) The Prudential Insurance loan is payable in monthly installments of \$827,000, which includes principal (based upon a 30-year amortization) and

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interest. A limited partner who is not a member of the Berg Group has guaranteed approximately \$12.0 million of this debt. Costs and fees incurred with obtaining this loan aggregated approximately \$900,000, which were deferred and amortized over the loan period.

- (3) Interest rate equal to LIBOR plus 1.75%. The Cupertino National Bank line of credit contains certain financial loan and reporting covenants as defined in the loan agreements, including minimum tangible net worth and debt service coverage ratio. As of March 31, 2006, the Company was in compliance with these loan covenants.
- (4) The Northwestern loan is payable in monthly installments of \$696,000, which includes principal (based upon a 20-year amortization) and interest. Costs and fees incurred with obtaining this loan aggregated approximately \$675,000, which were deferred and amortized over the loan period.
- (5) The Allianz loans are payable in monthly aggregate installments of \$1,017,000, which includes principal (based upon a 20-year amortization) and interest. Costs and fees incurred with obtaining these loans aggregated approximately \$1,089,000, which were deferred and amortized over the loan periods. The Allianz loans contain certain customary covenants as defined in the loan agreements. As of March 31, 2006, the Company was in compliance with these loan covenants.

At March 31, 2006, our debt to total market capitalization ratio, which is computed as our total debt outstanding divided by the sum of total debt outstanding plus the market value of common stock (based upon the closing price of \$11.75 per share on March 31, 2006) on a fully diluted basis, including the conversion of all O.P. units into common stock, was approximately 22.9%. On March 31, 2006, the last trading day for the quarter, total market capitalization was approximately \$1.6 billion.

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At March 31, 2006, the outstanding balance remaining under certain notes that we owed to the operating partnerships was \$1.7 million. The due date of these notes has been extended to September 30, 2007. The principal amount of these notes, along with the interest expense, which is interest income to the operating partnerships, is eliminated in consolidation and is not included in the corresponding line items within the consolidated financial statements. However, the interest income earned by the operating partnerships, which is interest expense to us, in connection with this debt, is included in the calculation of minority interest as reported on the consolidated statement of operations, thereby reducing our net income by this same amount. At present, our only means for repayment of this debt is through distributions that we receive from the operating partnerships that are in excess of the amount of dividends to be paid to our stockholders or by raising additional equity capital.

HISTORICAL CASH FLOWS

COMPARISON OF THE THREE MONTHS ENDED MARCH 31, 2006 TO THE THREE MONTHS ENDED MARCH 31, 2005

Net cash provided by operating activities for the three months ended March 31, 2006 was \$12.1 million compared to \$7.7 million for the same period in 2005. The increase resulted primarily from the increase in deferred rental income. The increase in cash flow from operating activities was also caused by payments of higher leasing commissions (included in other assets) in 2005, which amounted to approximately \$3.6 million compared to \$0.3 million in 2006.

Net cash provided by/(used in) investing activities was approximately \$1.8 million and (\$6.1) million for the three months ended March 31, 2006 and 2005, respectively. Cash used in investing activities during the three months ended

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March 31, 2006 related principally to the acquisition of the property at 233 South Hillview Drive for approximately \$13.5 million. That property acquisition was completed as a tax-deferred exchange transaction involving our former R&D property at 800 Embedded Way, San Jose, California. The remaining excess restricted cash of approximately \$1.8 million was transferred to our general cash account. Capital expenditures relating to real estate improvements were approximately \$79,000 and \$0.3 million for the three months ended March 31, 2006 and 2005, respectively.

Net cash used in financing activities was (\$5.4) million for the three months ended March 31, 2006 compared to (\$0.6) million for the three months ended March 31, 2005. During the first three months of 2006, we received \$0.1 million from stock option exercises, used \$2.6 million to pay outstanding debt, and paid \$2.9 million to common stockholders for dividends. During the same period in 2005, we used \$3.7 million to pay outstanding debt, drew an additional \$8.3 million from the Cupertino National Bank line of credit, and paid \$2.3 million to minority interests for distributions in excess of earnings and \$2.9 million to common stockholders for dividends.

FUNDS FROM OPERATIONS ("FFO")

FFO is a non-GAAP financial measurement used by real estate investment trusts to measure and compare operating performance. As defined by NAREIT, FFO represents net income (loss) before minority interest of O.P. unit holders, computed in accordance with GAAP, plus non-recurring events other than "extraordinary items" under GAAP, excluding gains and losses from sales of depreciable operating properties, plus real estate related depreciation and amortization, excluding amortization of deferred financing costs and depreciation of non-real estate assets, and after adjustments for unconsolidated partnerships and joint ventures. FFO does include impairment losses for properties held for sale and held for use. Management considers FFO to be an appropriate supplemental measure of the Company's operating and financial performance because when compared year over year, it reflects the impact to operations from trends in occupancy rates, rental rates, operating costs, general and administrative expenses and interest costs, providing a perspective not immediately apparent from net income. In addition, management believes that FFO provides useful information about the Company's financial performance when compared to other REITs since FFO is generally recognized as the industry standard for reporting the operations of REITs. In addition to the disclosure of operating earnings per share, we will continue to use FFO as a measure of our performance. FFO should not be considered as an alternative for net income as a measure of profitability nor is it comparable to cash flows provided by operating activities determined in accordance with GAAP, nor is FFO necessarily indicative of funds available to meet our cash needs, including the need to make cash distributions to satisfy REIT requirements. For example, FFO is not adjusted for payments of debt principal required under our debt service obligations.

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

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

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FFO for the three months ended March 31, 2006 and 2005, as reconciled to net

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income available to common stockholders, are summarized in the following tables:

| | Three Months Ended March 31, 2006 | 2005 |
|--|--------------------------------------|----------|
| ----- (dollars in thousands) | | |
| Net income available to common stockholders | \$ 5,152 | \$ 2,408 |
| Add: | | |
| Minority interests (1) | 23,256 | 11,574 |
| Depreciation & amortization of real estate (2) | 6,118 | 6,389 |
| Less: | | |
| Gain on sale of asset | - | (63) |
| | ----- | ----- |
| FFO | \$34,526 | \$20,308 |
| | ===== | ===== |

- (1) The minority interest for third parties totaling \$135 and \$121 for the three months ended March 31, 2006 and 2005, respectively, was deducted from total minority interest in calculating FFO.
- (2) Includes our portion of depreciation and amortization of real estate and leasing commissions from our unconsolidated joint venture totaling \$211 and \$354 for the three months ended March 31, 2006 and 2005, respectively. Also includes amortization of leasing commissions of \$428 for the three months ended March 31, 2006 and 2005. Amortization of leasing commissions is included in the property operating, maintenance and real estate taxes line item in the Company's consolidated statements of operations.

DISTRIBUTION POLICY

Our board of directors determines the amount and timing of distributions to our stockholders. The board of directors will consider many factors prior to making any distributions, including the following:

- the amount of cash available for distribution;
- our financial condition;
- whether to reinvest funds rather than to distribute such funds;
- our committed and projected capital expenditures;
- the amount of cash required for new property acquisitions, including acquisitions under existing agreements with the Berg Group;
- the amount of our annual debt service requirements;
- prospects of tenant renewals and re-leases of properties subject to expiring leases;
- cash required for re-leasing activities;
- the annual distribution requirements under the REIT provisions of the federal income tax laws; and
- such other factors as the board of directors deems relevant.

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

IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS

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

In May 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections" ("SFAS No. 154"), to replace APB Opinion 20, "Reporting Accounting

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Changes in Interim Financial Statements" ("APB 20"). SFAS No. 154 changes the requirements for the accounting for and reporting of a change in accounting principle and requires retrospective application to prior periods' financial statements, unless it is impracticable to determine period specific effects or the cumulative effect of the change. SFAS No. 154 will be effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The adoption of this statement is not expected to have a material effect on our consolidated results of operations or financial condition.

In December 2004, the FASB issued SFAS No. 123R, "Share-Based Payment" ("SFAS No. 123R"), which addresses the accounting for employee and director stock options. Statement 123R requires that the cost of all employee and director stock options, as well as other equity-based compensation arrangements, be reflected in the financial statements based on the estimated fair value of the awards. SFAS No. 123R is an amendment to SFAS No. 123 and supersedes APB Opinion No. 25 ("APB No. 25"). SFAS No. 123R is applicable to any award that is settled or measured in stock, including stock options, restricted stock, stock appreciation rights, stock units, and employee stock purchase plans. We have adopted the requirements of SFAS No. 123R effective January 1, 2006 using the modified prospective method of transition. Accordingly, prior periods have not been restated. The adoption of this standard did not have a material effect on our consolidated statements of operations or financial position.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We do not generally hold market risk sensitive instruments for trading purposes. We use fixed and variable rate debt to finance our operations. Our exposure to market risk for changes in interest rates relates primarily to our current variable rate debt and future debt obligations. We are vulnerable to significant fluctuations of interest rates on our floating rate debt and pricing on our future debt. We manage our market risk by monitoring interest rates where we try to recognize the unpredictability of the financial markets and seek to reduce potentially adverse effect on the results of our operations. This takes frequent evaluation of available lending rates and examination of opportunities to reduce interest expense through new sources of debt financing. Several factors affecting the interest rate risk include governmental monetary and tax policies, domestic and international economics and other factors that are beyond our control. The following table provides information about the principal cash flows, weighted average interest rates, and expected maturity dates for debt outstanding as of March 31, 2006. The current terms of this debt are described in Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources."

For fixed rate debt, the table presents the assumption that the outstanding principal balance at March 31, 2006 will be paid according to scheduled principal payments and that we will not prepay any of the outstanding principal balance.

| Nine Months Remaining | Year Ending December 31, | | | |
|-----------------------------|--------------------------|------|------|------|
| 2006 | 2007 | 2008 | 2009 | 2010 |

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(dollars in thousands)

Fixed Rate Debt:

| | | | | | |
|--------------------------------|---------|----------|-----------|---------|----------|
| Secured notes payable | \$7,847 | \$11,029 | \$121,605 | \$9,580 | \$10,125 |
| Weighted average interest rate | 5.84% | 5.84% | 5.84% | 5.84% | 5.84% |

The primary market risks we face are interest rate fluctuations. Principal amounts outstanding under the CNB line of credit, which had a balance of zero at March 31, 2006, is tied to a LIBOR based interest rate. As a result, we pay lower rates of interest in periods of decreasing interest rates and higher rates of interest in periods of increasing interest rates. All of our debt is denominated in United States dollars. We had no interest rate caps or interest rate swap contracts at March 31, 2006.

As of March 31, 2006, we had no interest rate risk since there was no variable rate debt outstanding.

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ITEM 4. CONTROLS AND PROCEDURES

DISCLOSURE CONTROLS AND PROCEDURES

We strive to maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives and management necessarily is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As required by SEC Rule 13a-15(b) we conducted an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer, President and Vice President of Finance, of the effectiveness of the design and operation of our disclosure controls and procedures. Based upon that evaluation, the Chief Executive Officer, President and Vice President of Finance concluded that our disclosure controls and procedures (as defined in Rule 13a-15(e) or Rule 15d-15(e)) were effective as of March 31, 2006.

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

There was no material change in our internal control over financial reporting during the last fiscal quarter that has materially affected, or is reasonably likely to materially affect our internal control over financial reporting.

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PART II - OTHER INFORMATION

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ITEM 1. LEGAL PROCEEDINGS

Legal proceedings are incorporated herein by reference from Part 1 "Item 1. - Financial Statements - Note 10 - Commitments and Contingencies."

ITEM 1A. RISK FACTORS

While we attempt to identify, manage and mitigate risks and uncertainties associated with our business to the extent practical under the circumstances, some level of risk and uncertainty will always be present. In addition to the other information contained in this report, you should carefully review the factors discussed under Item 1A of our 2005 Form 10-K which describes some of the risks and uncertainties associated with our business. These risks and uncertainties have the potential to materially affect our business, financial condition, results of operations, cash flows, and future prospects. Additional risks and uncertainties not presently known to us or that we currently deem immaterial also may impair our business operations.

ITEM 6. EXHIBITS

- 31.1 Section 1350 Certificate of CEO
- 31.2 Section 1350 Certificate of President & COO
- 31.3 Section 1350 Certificate of Principal Financial Officer
- 32 Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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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 thereto duly authorized.

Mission West Properties, Inc.
(Registrant)

Date: May 9, 2006

By: /s/ Carl E. Berg

Carl E. Berg
Chief Executive Officer

Date: May 9, 2006

By: /s/ Wayne N. Pham

Wayne N. Pham
Vice President of Finance and Controller
(Principal Accounting Officer and Duly
Authorized Officer)

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