ALEXANDRIA REAL ESTATE EQUITIES INC
Form 10-Q
August 04, 2010
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2010

OR

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

For the transition period from ____________ to ____________

Commission file number 1-12993

ALEXANDRIA REAL ESTATE EQUITIES, INC.

(Exact name of registrant as specified in its charter)

Maryland	**95-4502084**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

385 East Colorado Boulevard, Suite 299, Pasadena, California 91101

(Address of principal executive offices)(Zip Code)

(626) 578-0777

(Registrant s telephone number, including area code)

N/A

(Former name, former address and former fiscal year, if changed since last report)

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 x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

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

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

As of July 30, 2010, 49,996,702 shares of common stock, par value $.01 per share, were outstanding.

Table of Contents

TABLE OF CONTENTS

Table of Contents

PART I - FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS (UNAUDITED)

Table of Contents

Alexandria Real Estate Equities, Inc.

Condensed Consolidated Balance Sheets

(In thousands)

(Unaudited)

	June 30, 2010	December 31, 2009
Assets		
Investments in real estate:		
Rental properties	$ 3,979,016	$ 3,903,955
Less: accumulated depreciation	(562,755)	(520,647)
Rental properties, net	3,416,261	3,383,308
Land held for future development	309,514	255,025
Construction in progress	1,394,778	1,400,795
Investment in unconsolidated real estate entity	35,184	
Investments in real estate, net	5,155,737	5,039,128
Cash and cash equivalents	73,254	70,628
Restricted cash	37,660	47,291
Tenant receivables	3,059	3,902
Deferred rent	102,422	96,700
Investments	77,088	72,882
Other assets	115,939	126,696
Total assets	$ 5,565,159	$ 5,457,227
Liabilities and Equity		
Secured notes payable	$ 859,831	$ 937,017
Unsecured line of credit and unsecured term loan	1,446,000	1,226,000
Unsecured convertible notes	378,580	583,929
Accounts payable, accrued expenses, and tenant security deposits	300,035	282,516
Dividends payable	23,683	21,686
Total liabilities	3,008,129	3,051,148
Redeemable noncontrolling interests	17,014	41,441
Alexandria Real Estate Equities, Inc. stockholders equity:		
Series C preferred stock	129,638	129,638
Series D convertible preferred stock	250,000	250,000
Common stock	496	438
Additional paid-in capital	2,158,591	1,977,062
Accumulated other comprehensive loss	(40,377)	(33,730)
Total Alexandria Real Estate Equities, Inc. stockholders equity	2,498,348	2,323,408
Noncontrolling interests	41,668	41,230
Total equity	2,540,016	2,364,638
Total	$ 5,565,159	$ 5,457,227

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

Table of Contents

Alexandria Real Estate Equities, Inc.

Condensed Consolidated Income Statements

(Dollars in thousands, except per share amounts)

(Unaudited)

	Three Months Ended June 30, 2010	Three Months Ended June 30, 2009	Six Months Ended June 30, 2010	Six Months Ended June 30, 2009
Revenues				
Rental	$ 89,512	$ 87,461	$ 178,370	$ 191,472
Tenant recoveries	26,576	24,668	53,134	51,464
Other income	922	8,910	1,993	9,662
Total Revenues	117,010	121,039	233,497	252,598
Expenses				
Rental operations	30,352	29,224	62,003	61,658
General and administrative	8,266	8,804	17,747	18,222
Interest	18,778	21,373	36,340	41,572
Depreciation and amortization	30,342	29,500	60,077	60,742
Total Expenses	87,738	88,901	176,167	182,194
(Loss) gain on early extinguishment of debt	(41,496)	11,254	(41,496)	11,254
(Loss) income from continuing operations	(12,224)	43,392	15,834	81,658
Income from discontinued operations, net		724	727	3,707
Net (loss) income	(12,224)	44,116	16,561	85,365
Net income attributable to noncontrolling interests	930	4,362	1,865	5,237
Dividends on preferred stock	7,090	7,089	14,179	14,178
Net income attributable to unvested restricted stock awards	149	367	311	868
Net (loss) income attributable to Alexandria Real Estate Equities, Inc. s common stockholders	$ (20,393)	$ 32,298	$ 206	$ 65,082
(Loss) earnings per share attributable to Alexandria Real Estate Equities, Inc. s common stockholders basic				
Continuing operations	$ (0.45)	$ 0.81	$ (0.02)	$ 1.72
Discontinued operations, net		0.02	0.02	0.10
(Loss) earnings per share basic	$ (0.45)	$ 0.83	$	$ 1.82
(Loss) earnings per share attributable to Alexandria Real Estate Equities, Inc. s common stockholders diluted				
Continuing operations	$ (0.45)	$ 0.80	$ (0.02)	$ 1.71
Discontinued operations, net		0.02	0.02	0.10
(Loss) earnings per share diluted	$ (0.45)	$ 0.82	$	$ 1.81

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

Table of Contents

Alexandria Real Estate Equities, Inc.

Condensed Consolidated Statement of Changes in Stockholders Equity and Noncontrolling Interests

(Dollars in thousands)

(Unaudited)

	Alexandria Real Estate Equities, Inc. Stockholders									
	Series C Preferred Stock	**Series D Convertible Preferred Stock**	**Number of Common Shares**	**Common Stock**	**Additional Paid-In Capital**	**Retained Earnings**	**Accumulated Other Comprehensive Loss**	**Noncontrolling Interests**	**Total Equity**	**Redeemable Noncontrolling Interests**
Balance at December 31, 2009	$ 129,638	$ 250,000	43,846,050	$ 438	$ 1,977,062	$ -	$ (33,730)	$ 41,230	$ 2,364,638	$ 41,441
Net income	-	-	-	-	-	14,696	-	1,228	15,924	637
Unrealized gain on marketable securities	-	-	-	-	-	-	(1,853)	-	(1,853)	-
Unrealized gain on interest rate hedge agreements	-	-	-	-	-	-	(2,161)	-	(2,161)	80
Foreign currency translation	-	-	-	-	-	-	(2,633)	4	(2,629)	-
Contributions by noncontrolling interests	-	-	-	-	-	-	-	655	655	674
Distributions to noncontrolling interests	-	-	-	-	-	-	-	(1,449)	(1,449)	(688)
Redemption of redeemable noncontrolling interests	-	-	-	-	(150)	-	-	-	(150)	(1,125)
Deconsolidation of investment in real estate entity (see Note 3)	-	-	-	-	-	-	-	-	-	(24,005)
Exchange of 8.00% unsecured convertible notes (see Note 6)	-	-	5,620,256	56	203,051	-	-	-	203,107	-
Issuances pursuant to stock plan	-	-	168,090	2	11,114	-	-	-	11,116	-
Dividends declared on preferred stock	-	-	-	-	-	(14,179)	-	-	(14,179)	-
Dividends declared on common stock	-	-	-	-	-	(33,003)	-	-	(33,003)	-
Distributions in excess of earnings	-	-	-	-	(32,486)	32,486	-	-	-	-
Balance at June 30, 2010	$ 129,638	$ 250,000	49,634,396	$ 496	$ 2,158,591	$ -	$ (40,377)	$ 41,668	$ 2,540,016	$ 17,014

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

Table of Contents

Alexandria Real Estate Equities, Inc.
Condensed Consolidated Statements of Cash Flows
(In thousands)
(Unaudited)

	Six Months Ended June 30, 2010	Six Months Ended June 30, 2009
Operating Activities		
Net income	$ 16,561	$ 85,365
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	60,080	61,168
Loss (gain) on early extinguishment of debt	41,496	(11,254)
Amortization of loan fees and costs	4,098	3,816
Amortization of debt premiums/discount	5,875	4,867
Amortization of acquired above and below market leases	(3,577)	(6,481)
Deferred rent	(7,440)	(4,209)
Stock compensation expense	5,389	6,716
Equity in income related to investments	(48)	(39)
Gain on sales of investments	(762)	(1,889)
Loss on sales of investments	21	604
Gain on sales of property	(24)	(2,234)
Changes in operating assets and liabilities:		
Restricted cash	1,955	(2,148)
Tenant receivables	1,094	1,788
Other assets	(11,806)	(6,885)
Accounts payable, accrued expenses, and tenant security deposits	8,356	(17,144)
Net cash provided by operating activities	121,268	112,041
Investing Activities		
Additions to properties	(219,241)	(241,606)
Proceeds from sales of properties	10,514	11,929
Change in restricted cash related to construction projects	12,706	21,513
Contributions to unconsolidated real estate entity	(1,550)	
Transfer of cash to unconsolidated real estate entity upon deconsolidation	(154)	
Additions to investments	(7,929)	(4,905)
Proceeds from investments	2,659	2,364
Net cash used in investing activities	(202,995)	(210,705)
Financing Activities		
Proceeds from secured notes payable		1,082
Principal reductions of secured notes payable	(38,646)	(141,438)
Change in restricted cash related to financings	(8,048)	(2,410)
Principal borrowings from unsecured line of credit and term loan	272,000	390,000
Repayments of borrowings from unsecured line of credit	(52,000)	(508,000)
Proceeds from issuance of 8.00% unsecured convertible notes		232,950
Payment on exchange of 8.00% unsecured convertible notes	(43,528)	
Repurchase of 3.70% unsecured convertible notes		(59,204)
Proceeds from issuance of common stock		254,630
Proceeds from exercise of stock options	1,843	31
Dividends paid on common stock	(31,006)	(57,397)
Dividends paid on preferred stock	(14,179)	(14,178)
Contributions by redeemable noncontrolling interests	674	4,721
Distributions to redeemable noncontrolling interests	(688)	(698)

Redemption of redeemable noncontrolling interests		(1,275)		(1,052)
Contributions by noncontrolling interests		655		
Distributions to noncontrolling interests		(1,449)		(1,221)
Net cash provided by financing activities		84,353		97,816
Net increase (decrease) in cash and cash equivalents		2,626		(848)
Cash and cash equivalents at beginning of period		70,628		71,161
Cash and cash equivalents at end of period	$	73,254	$	70,313

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

Table of Contents

Alexandria Real Estate Equities, Inc.
Notes to Condensed Consolidated Financial Statements
(Unaudited)

1. Background

As used in this quarterly report on Form 10-Q, references to the Company, we, our, and us refer to Alexandria Real Estate Equities, Inc. and its subsidiaries.

Alexandria Real Estate Equities, Inc., Landlord of Choice to the Life Science Industry®, is the largest owner and preeminent real estate investment trust (REIT) focused principally on cluster development through the ownership, operation, management, selective redevelopment, development, and acquisition of properties containing life science laboratory space. We are the leading provider of high-quality, environmentally sustainable real estate, technical infrastructure, and services to the broad and diverse life science industry. Client tenants include institutional (universities and independent not-for-profit institutions), pharmaceutical, biotechnology, medical device, product, service, and translational entities, as well as government agencies. Our operating platform is based on the principle of clustering, with assets and operations located in key life science markets. Our asset base contains 161 properties approximating 12.7 million rentable square feet consisting of 156 properties approximating 11.8 million rentable square feet (including spaces undergoing active redevelopment) and five properties undergoing ground-up development approximating an additional 865,000 rentable square feet. In addition, our asset base will enable us to grow to approximately 24.1 million rentable square feet through additional ground-up development of approximately 11.4 million rentable square feet.

2. Basis of presentation

We have prepared the accompanying interim condensed consolidated financial statements in accordance with accounting principles generally accepted in the United States (GAAP) and in conformity with the rules and regulations of the Securities and Exchange Commission (SEC). In our opinion, the interim condensed consolidated financial statements presented herein reflect all adjustments, consisting solely of normal and recurring adjustments, which are necessary to fairly present the interim condensed consolidated financial statements. The results of operations for the interim period are not necessarily indicative of the results that may be expected for the year ending December 31, 2010. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in our annual report on Form 10-K for the year ended December 31, 2009.

The accompanying condensed consolidated financial statements include the accounts of Alexandria Real Estate Equities, Inc. and its subsidiaries. All significant intercompany balances and transactions have been eliminated.

We hold interests, together with certain third parties, in a limited partnership and in limited liability companies which we consolidate in our financial statements. We consolidate the limited partnership and limited liability companies because we exercise significant control over major decisions by these entities, such as investing and financing activities.

Reclassifications

Certain prior period amounts have been reclassified to conform to the current period presentation.

International operations

The functional currency for our subsidiaries operating in the United States is the United States dollar. We have four operating properties and one development parcel in Canada and development parcels in Asia. The functional currencies for our foreign subsidiaries are the local currencies in each respective country. The assets and liabilities of our foreign subsidiaries are translated into United States dollars at the exchange rate in effect as of the financial statement date. Income statement accounts of our foreign subsidiaries are translated using the average exchange rate for the periods presented. Gains or losses resulting from the translation are included in accumulated other comprehensive income (loss) as a separate component of total equity.

The appropriate amounts of foreign exchange rate gains or losses included in accumulated other comprehensive income (loss) will be reflected in income when there is a sale or partial sale of our investment in these operations or upon a complete or substantially complete liquidation of the investment.

Table of Contents

2. Basis of presentation (continued)

Rental properties, net, land held for future development, and construction in progress

We recognize assets acquired (including the intangible values to above or below market leases, acquired in-place leases, tenant relationships and other intangible assets or liabilities), liabilities assumed and any noncontrolling interest in an acquired entity at their fair value as of the acquisition date. The value of tangible assets acquired is based upon our estimation of value on an as if vacant basis. The value of acquired in-place leases includes the estimated carrying costs during the hypothetical lease-up period and other costs that would have been incurred to execute similar leases, considering market conditions at the acquisition date of the acquired in-place lease. The values of acquired in-place leases are classified as leasing costs, included in other assets in the accompanying condensed consolidated balance sheets and amortized over the remaining terms of the related leases. We assess the fair value of tangible and intangible assets based on numerous factors, including estimated cash flow projections that utilize appropriate discount and capitalization rates and available market information. Estimates of future cash flows are based on a number of factors including the historical operating results, known trends and market/economic conditions that may affect the property. We also recognize the fair values of assets acquired, the liabilities assumed, and any noncontrolling interests in acquisitions of less than a 100% interest when the acquisition constitutes a change in control of the acquired entity. In addition, acquisition-related costs and restructuring costs are expensed as incurred.

We are required to capitalize construction, redevelopment, and development costs, including preconstruction costs, interest, property taxes, insurance, and other costs directly related and essential to the project while activities are ongoing to prepare an asset for its intended use. Capitalization of interest and other direct project costs ceases after a project is substantially complete and ready for its intended use. In addition, should activities necessary to prepare an asset for its intended use cease, interest, taxes, insurance, and certain other costs would be expensed as incurred. Expenditures for repairs and maintenance are expensed as incurred.

Rental properties, net, land held for future development, construction in progress, and intangibles are individually evaluated for impairment when conditions exist that may indicate that it is probable that the sum of expected future undiscounted cash flows is less than the carrying amount. Impairment indicators for our rental properties, land held for future development, and construction in progress are assessed by project and include, but are not limited to, significant fluctuations in estimated net operating income, occupancy changes, construction costs, estimated completion dates, rental rates, and other market factors. We assess the expected undiscounted cash flows based upon numerous factors, including, but not limited to, construction costs, available market information, historical operating results, known trends, and market/economic conditions that may affect the property and our assumptions about the use of the asset, including, if necessary, a probability-weighted approach if multiple outcomes are under consideration. Upon determination that an impairment has occurred, a write-down is recorded to reduce the carrying amount to its estimated fair value. We did not incur impairment charges for the three and six months ended June 30, 2010 and 2009.

Variable interest entity

In June 2009, the Financial Accounting Standards Board (the FASB) issued new accounting literature with respect to variable interest entities (VIEs). The new guidance impacts the consolidation guidance applicable to VIEs and among other things requires a qualitative rather than a quantitative analysis to determine the primary beneficiary of a VIE, continuous assessments of whether a company is the primary beneficiary of a VIE, and enhanced disclosures about a company s involvement with a VIE. We prospectively adopted the new guidance on January 1, 2010.

We consolidate a VIE if it is determined that we are the primary beneficiary, an evaluation that we perform on an ongoing basis. A VIE is broadly defined as an entity where either (i) the equity investors as a group, if any, do not have a controlling financial interest, or (ii) the equity investment at risk is insufficient to finance that entity s activities without additional subordinated financial support. We use qualitative analyses when determining whether or not we are the primary beneficiary of a VIE. Consideration of various factors includes, but is not limited to, the purpose and design of the VIE, risks that the VIE was designed to create and pass through, the form of our ownership interest, our representation of the entity s governing body, the size and seniority of our investment, our ability to participate in policy making decisions, and the rights of the other investors to participate in the decision making process, and to replace us as manager and/or liquidate the venture, if applicable. Our ability to correctly assess our influence or control over an entity at the inception of our involvement with the entity or upon reevaluation of the entity s continuing status as a VIE and determine the primary beneficiary of a VIE affects the presentation of these entities in our consolidated financial statements. See Note 3, Investments in Real Estate, Net.

Table of Contents

2. Basis of presentation (continued)

Interest rate hedge agreements

We utilize interest rate hedge agreements to hedge a portion of our exposure to variable interest rates primarily associated with our unsecured line of credit and unsecured term loan. We recognize our interest rate hedge agreements as either assets or liabilities on the balance sheet at fair value. The accounting for changes in fair value (i.e., gains or losses) of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and further, on the type of hedging relationship. For those derivative instruments that are designated and qualify as hedging instruments, a company must designate the hedging instrument, based upon the hedged exposure, as a fair value hedge, cash flow hedge, or a hedge of a net investment in a foreign operation. Our interest rate hedge agreements are considered cash flow hedges as they are designated and qualify as hedges of the exposure to variability in expected future cash flows. Hedge accounting generally provides for the matching of the timing of gain or loss recognition on the hedging instrument with the recognition of the changes in the earnings effect of the hedged forecasted transactions in a cash flow hedge.

Accumulated other comprehensive loss

Accumulated other comprehensive loss attributable to Alexandria Real Estate Equities, Inc. consists of the following (in thousands):

	June 30, 2010	December 31, 2009
Unrealized gain on marketable securities	$ 5,427	$ 7,280
Unrealized loss on interest rate hedge agreements	(52,204)	(50,043)
Unrealized gain on foreign currency translation	6,400	9,033
	$ (40,377)	$ (33,730)

The following table provides a reconciliation of comprehensive income (loss) attributable to Alexandria Real Estate Equities, Inc. (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Net (loss) income	$ (12,224)	$ 44,116	$ 16,561	$ 85,365
Unrealized (loss) gain on marketable securities	(2,190)	(350)	(1,853)	342
Unrealized (loss) gain on interest rate hedge agreements	(3,188)	15,858	(2,081)	27,189
Unrealized (loss) gain on foreign currency translation	(8,004)	11,314	(2,629)	6,656
Comprehensive (loss) income	(25,606)	70,938	9,998	119,552
Comprehensive income attributable to noncontrolling interests	935	4,329	1,949	5,196
	$ (26,541)	$ 66,609	$ 8,049	$ 114,356

Comprehensive (loss) income attributable to
Alexandria Real Estate Equities, Inc.

Income Taxes

We are organized and qualify as a REIT pursuant to the Internal Revenue Code of 1986, as amended (the Code). Under the Code, a REIT that distributes at least 90% of its REIT taxable income as a dividend to its shareholders each year and that meets certain other conditions is not subject to federal income taxes, but is subject to certain state and local taxes. We generally distribute 100% or more of our taxable income. Therefore, no provision for federal income taxes is required. We file tax returns, including returns for our subsidiaries, with federal, state and local jurisdictions, including jurisdictions located in the United States, Canada, China, and other international locations. Our tax returns are subject to examination in various jurisdictions for the calendar years 2005 through 2009.

Table of Contents

2. Basis of presentation (continued)

Income Taxes (continued)

We recognize tax benefits of uncertain tax positions only if it is more likely than not that the tax position will be sustained, based solely on its technical merits, with the taxing authority having full knowledge of all relevant information. The measurement of a tax benefit for an uncertain tax position that meets the more likely than not threshold is based on a cumulative probability model under which the largest amount of tax benefit recognized is the amount with a greater than 50% likelihood of being realized upon ultimate settlement with the taxing authority having full knowledge of all the relevant information. As of June 30, 2010, there were no unrecognized tax benefits. We do not anticipate a significant change to the total amount of unrecognized tax benefits within the next 12 months.

Interest expense and penalties, if any, would be recognized in the first period the interest or penalty would begin accruing according to the provisions of the relevant tax law at the applicable statutory rate of interest. We did not incur any tax related interest expense or penalties for the three and six months ended June 30, 2010 and 2009.

(Loss) earnings per share and dividends declared

We account for unvested restricted stock awards which contain nonforfeitable rights to dividends as participating securities and include these securities in the computation of (loss) earnings per share using the two-class method. Under the two-class method, we allocate net income after preferred stock dividends and amounts attributable to noncontrolling interests to common stockholders and unvested restricted stock awards based on their respective participation rights to dividends declared (or accumulated) and undistributed earnings. Diluted (loss) earnings per share is computed using the weighted average shares of common stock outstanding determined for the basic (loss) earnings per share computation plus the effect of any dilutive securities, including the dilutive effect of stock options using the treasury stock method. We use (loss) income from continuing operations attributable to Alexandria Real Estate Equities, Inc s common stockholders as the control number in determining whether potential shares of common stock issuable upon exercise of outstanding stock options are dilutive or antidilutive to (loss) earnings per share. For the three and six months ended June 30, 2010, the effect of stock options using the treasury stock method was antidilutive to loss per share from continuing operations attributable to Alexandria Real Estate Equities, Inc. s common stockholders and as such, shares of common stock issuable upon exercise of outstanding stock options were excluded from the computation of diluted loss per share.

The following table shows the computation of (loss) earnings per share and dividends declared per common share (dollars in thousands, except per share amounts):

	Three Months Ended June 30,		Six Months Ended June 30,	
Numerator:	**2010**	**2009**		