CATELLUS DEVELOPMENT CORP
Form 10-Q
August 14, 2003
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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 fiscal quarter ended June 30, 2003

Commission file number 1-10622

CATELLUS DEVELOPMENT CORPORATION

(Exact name of Registrant as specified in its charter)

Delaware	**94-2953477**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

201 Mission Street
San Francisco, California 94105
(Address of principal executive offices and zip code)

Registrant s telephone number, including area code:
(415) 974-4500

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 is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).
x Yes   o No

As of August 11, 2003, there were 89,394,866 issued and outstanding shares of the Registrant s Common Stock.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

CATELLUS DEVELOPMENT CORPORATION

Condensed Consolidated Balance Sheet
(In thousands)

	June 30, 2003	December 31, 2002
	(Unaudited)	
Assets		
Properties	$ 2,490,887	$ 2,448,081
Less accumulated depreciation	(427,716)	(399,923)
	2,063,171	2,048,158
Other assets and deferred charges, net	299,902	273,853
Notes receivable, less allowance	44,373	44,947
Accounts receivable, less allowance	16,723	14,211
Assets held for sale		2,760
Restricted cash and investments	34,064	36,593
Cash and cash equivalents	204,186	274,927
Total	$ 2,662,419	$ 2,695,449
Liabilities and stockholders equity		
Mortgage and other debt	$ 1,482,178	$ 1,500,955
Accounts payable and accrued expenses	76,409	117,493
Deferred credits and other liabilities	175,680	151,466
Liabilities associated with assets held for sale		3,233
Deferred income taxes	315,630	318,970
Total liabilities	2,049,897	2,092,117
Commitments and contingencies (Note 8)		
Minority interests		57,363
Stockholders equity		
Common stock, 112,273 and 110,817 shares issued and 88,626 and 87,170 shares outstanding at June 30, 2003 and December 31, 2002, respectively	1,123	1,108
Paid-in capital	555,235	531,362
Treasury stock, at cost (23,647 shares at June 30, 2003 and December 31, 2002)	(401,082)	(401,082)
Accumulated earnings	457,246	414,581
Total stockholders equity	612,522	545,969
Total	$ 2,662,419	$ 2,695,449

See notes to Condensed Consolidated Financial Statements

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CATELLUS DEVELOPMENT CORPORATION
CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS
(In thousands, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	**2002**	**2003**	**2002**
	(Unaudited)		(Unaudited)	
Revenue				
Rental revenue	$ 74,447	$ 64,725	$ 148,567	$ 127,600
Sales revenue	24,900	43,998	32,910	98,692
Management, development and other fees	4,863	1,764	6,947	2,896
	104,210	110,487	188,424	229,188
Costs and expenses				
Property operating costs	(20,166)	(17,192)	(39,600)	(32,880)
Cost of sales	(20,281)	(28,167)	(23,253)	(67,252)
Selling, general and administrative expenses	(5,662)	(6,130)	(11,154)	(13,980)
Corporate administrative costs	(4,505)	(4,362)	(8,904)	(8,464)
Depreciation and amortization	(17,732)	(14,934)	(34,292)	(28,349)
	(68,346)	(70,785)	(117,203)	(150,925)
Operating income	35,864	39,702	71,221	78,263
Other income				
Equity in earnings of operating joint ventures, net	2,136	2,324	4,659	5,845
Equity in earnings of development joint ventures, net	5,427	8,177	9,281	15,624
Gain on non-strategic asset sales	1,478	7,059	7,357	6,821
Interest income	1,796	2,556	3,713	5,145
Other	792	41	1,949	8,166
	11,629	20,157	26,959	41,601
Other expenses				
Interest expense	(17,149)	(13,898)	(33,941)	(26,442)
REIT transition costs	(1,805)		(3,363)	
Other	(196)	(752)	(196)	(1,445)
	(19,150)	(14,650)	(37,500)	(27,887)
Income before minority interests, income taxes, and discontinued operations	28,343	45,209	60,680	91,977
Minority interests		(1,526)		(3,053)
Income before income taxes and discontinued operations	28,343	43,683	60,680	88,924
Income tax expense	(10,846)	(17,565)	(22,585)	(35,762)
Income from continuing operations	17,497	26,118	38,095	53,162
Discontinued operations, net of income tax:				

Gain from disposal of discontinued operations	1,780	7,550	4,419	12,055
Income (loss) from discontinued operations	(23)	(29)	151	(94)
Net gain from discontinued operations	1,757	7,521	4,570	11,961
Net income	$ 19,254	$ 33,639	$ 42,665	$ 65,123
Income per share from continuing operations				
Basic	$ 0.20	$ 0.30	$ 0.44	$ 0.61
Assuming dilution	$ 0.19	$ 0.29	$ 0.42	$ 0.59
Income per share from discontinued operations				
Basic	$ 0.02	$ 0.09	$ 0.05	$ 0.14
Assuming dilution	$ 0.02	$ 0.08	$ 0.05	$ 0.14
Net income per share				
Basic	$ 0.22	$ 0.39	$ 0.49	$ 0.75
Assuming dilution	$ 0.21	$ 0.37	$ 0.47	$ 0.73
Average number of common shares outstanding - basic	87,730	86,976	87,493	86,815
Average number of common shares outstanding - diluted	90,756	89,864	90,375	89,508

See notes to Condensed Consolidated Financial Statements

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CATELLUS DEVELOPMENT CORPORATION

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS
(In thousands)

	Six Months Ended June 30, 2003	Six Months Ended June 30, 2002
	(Unaudited)	
Cash flows from operating activities:		
Net income	$ 42,665	$ 65,123
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	34,292	28,349
Deferred income taxes	274	16,663
Deferred gain recognized	(3,504)	(14,255)
Amortization of deferred loan fees and other costs	2,212	3,398
Equity in earnings of joint ventures	(13,940)	(21,469)
Operating distributions from joint ventures	14,838	62,098
Gain on sales of investment property	(7,365)	(20,165)
Cost of development property and non-strategic assets sold	34,640	59,621
Capital expenditures for development property	(45,047)	(28,038)
Other, net	(2,948)	10,227
Change in deferred credits and other liabilities	31,671	8,660
Change in other operating assets and liabilities	(28,238)	(11,008)
Net cash provided by operating activities	59,550	159,204
Cash flows from investing activities:		
Net proceeds from sale of investment property	27,800	25,011
Capital expenditures for investment property	(149,364)	(179,519)
Payment of reimbursable construction costs	(11,629)	(30,382)
Distributions from joint ventures	8,601	
Contributions to joint ventures	(5,287)	(9,180)
Net decrease (increase) in restricted cash	2,529	(18,594)
Net cash used in investing activities	(127,350)	(212,664)
Cash flows from financing activities:		
Borrowings	11,339	165,319
Repayment of borrowings	(28,168)	(124,103)
Distributions to minority partners	(4,551)	(4,540)
Proceeds from issuance of common stock	18,439	8,395
Net cash (used in) provided by financing activities	(2,941)	45,071
Net decrease in cash and cash equivalents	(70,741)	(8,389)
Cash and cash equivalents at beginning of period	274,927	222,695
Cash and cash equivalents at end of period	$ 204,186	$ 214,306
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest (net of amount capitalized)	$ 31,850	$ 27,215

Income taxes	$	40,547	$	16,692
Non-cash financing activities:				
Debt forgiveness-property reconveyance	$	(5,095)	$	

See notes to Condensed Consolidated Financial Statements

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CATELLUS DEVELOPMENT CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2003
(Unaudited)

NOTE 1. DESCRIPTION OF BUSINESS

Catellus Development Corporation, together with its consolidated subsidiaries (Catellus or the Company), is a diversified real estate operating company, with a large portfolio of rental properties and developable land, that manages and develops real estate for its own account and those of others. Interests of third parties in entities controlled and consolidated by the Company are separately reflected as minority interests in the accompanying financial statements. The Company s rental portfolio and developable land, consisting of industrial, residential, retail, office, and other projects are located mainly in major markets in California, Illinois, Texas, Colorado, and Oregon.

On March 3, 2003, the Company announced that its Board of Directors has authorized it to restructure its business operations in order to qualify as a real estate investment trust (REIT), effective January 1, 2004. The REIT conversion is subject to stockholder approval as well as final Board approval. The Company anticipates that its stockholders meeting will be in the third quarter of 2003 (see Note 11).

NOTE 2. INTERIM FINANCIAL DATA

The accompanying Condensed Consolidated Financial Statements should be read in conjunction with the Company s 2002 Annual Report on Form 10-K/A as filed with the Securities and Exchange Commission. In the opinion of management, the accompanying financial information includes all normal and recurring adjustments necessary to present fairly the financial position, results of operations, and cash flows for the interim periods presented. Certain prior period financial data have been reclassified to conform to the current period presentation.

Accounting for stock based compensation

At June 30, 2003, the Company has five stock-based employee compensation plans. The Company accounts for those plans under the recognition and measurement principles of Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, and related Interpretations. No stock-based employee compensation cost is reflected in net income, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of Statement of Financial Accounting Standards Board (FASB) No. 123, *Accounting for Stock-Based Compensation* , to stock-based employee compensation.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	**2002**	**2003**	**2002**
	(In thousands)		**(In thousands)**	
Net income, as reported	$ 19,254	$ 33,639	$ 42,665	$ 65,123
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(1,206)	(1,342)	(2,620)	(2,671)
Pro forma net income	$ 18,048	$ 32,297	$ 40,045	$ 62,452
Earnings per share:				
Basic as reported	$ 0.22	$ 0.39	$ 0.49	$ 0.75
Basic pro forma	$ 0.21	$ 0.37	$ 0.46	$ 0.72
Diluted as reported	$ 0.21	$ 0.37	$ 0.47	$ 0.73
Diluted pro forma	$ 0.20	$ 0.36	$ 0.44	$ 0.70

Income taxes

Income tax expense on income from continuing operations for the three and six months ended June 30, 2003 and 2002 consisted of the following:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002	2003	2002
	(In thousands)		(In thousands)	
Current	$ (7,600)	$ (11,497)	$ (22,311)	$ (19,099)
Deferred	(3,246)	(6,068)	(274)	(16,663)
Total	$ (10,846)	$ (17,565)	$ (22,585)	$ (35,762)

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Non strategic asset sales

The Company s sales of non-strategic assets are summarized as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002	2003	2002
	(In thousands)		(In thousands)	
Sales	$ 1,735	$ 7,683	$ 7,938	$ 7,813
Cost of sales	(257)	(624)	(581)	(992)
Gain	$ 1,478	$ 7,059	$ 7,357	$ 6,821

NOTE 3. RESTRICTED CASH AND INVESTMENTS

Of the total restricted cash and investments of $34.1 million at June 30, 2003, and $36.6 million at December 31, 2002, $0.7 million and $5.1 million, respectively, represent proceeds from property sales held in separate cash accounts at trust companies in order to preserve the Company s option to reinvest the proceeds on a tax-deferred basis. Approximately $23.4 million and $24.6 million at June 30, 2003 and December 31, 2002, respectively, represents funds held in pledge accounts at a bank until certain loan collateral pool requirements are met, and $4.0 million at June 30, 2003, represents a reserve fund held by a lender in anticipation of substitution of real property collateral. In addition, restricted investments of $6.0 million and $6.9 million at June 30, 2003 and December 31, 2002, respectively, represent certificates of deposits used to guarantee lease performance for certain properties that secure debt.

NOTE 4. INCOME PER SHARE

Income from continuing and discontinued operations per share of common stock is computed by dividing respective income by the weighted average number of shares of common stock and equivalents outstanding during the period (see table below for effect of dilutive securities, and Notes 2 and 10).

	Three Months Ended June 30,					
	2003			2002		
	Income	Shares	Per Share Amount	Income	Shares	Per Share Amount
	(In thousands, except per share data)					
Income from continuing operations	$ 17,497	87,730	$ 0.20	$ 26,118	86,976	$ 0.30
Effect of dilutive securities: stock options		3,026			2,888	
Income from continuing operations assuming dilution	$ 17,497	90,756	$ 0.19	$ 26,118	89,864	$ 0.29
Net gain from discontinued operations	$ 1,757	87,730	$ 0.02	$ 7,521	86,976	$ 0.09
Effect of dilutive securities: stock options		3,026			2,888	
Net gain from discontinued operations assuming dilution	$ 1,757	90,756	$ 0.02	$ 7,521	89,864	$ 0.08
Net income	$ 19,254	87,730	$ 0.22	$ 33,639	86,976	$ 0.39

Effect of dilutive securities: stock options		3,026			2,888	
Net income assuming dilution	$ 19,254	90,756	$ 0.21	$ 33,639	89,864	$ 0.37

	Six Months Ended June 30,					
	2003			2002		
	Income	Shares	Per Share Amount	Income	Shares	Per Share Amount
	(In thousands, except per share data)					
Income from continuing operations	$ 38,095	87,493	$ 0.44	$ 53,162	86,815	$ 0.61
Effect of dilutive securities: stock options		2,882			2,693	
Income from continuing operations assuming dilution	$ 38,095	90,375	$ 0.42	$ 53,162	89,508	$ 0.59
Net gain from discontinued operations	$ 4,570	87,493	$ 0.05	$ 11,961	86,815	$ 0.14
Effect of dilutive securities: stock options		2,882			2,693	
Net gain from discontinued operations assuming dilution	$ 4,570	90,375	$ 0.05	$ 11,961	89,508	$ 0.14
Net income	$ 42,665	87,493	$ 0.49	$ 65,123	86,815	$ 0.75
Effect of dilutive securities: stock options		2,882			2,693	
Net income assuming dilution	$ 42,665	90,375	$ 0.47	$ 65,123	89,508	$ 0.73

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NOTE 5. MORTGAGE AND OTHER DEBT

Mortgage and other debt at June 30, 2003 and December 31, 2002, are summarized as follows:

	June 30, 2003	December 31, 2002
	(In thousands)	
Fixed rate mortgage loans	$ 1,066,579	$ 1,080,655
Floating rate mortgage loans	203,015	207,212
Construction loans	83,604	78,244
Land acquisition and development loans	20,358	22,241
Assessment district bonds	100,148	103,935
Other loans	8,474	8,668
Mortgage and other debt	1,482,178	1,500,955
Liabilities of assets held for sale:		
Fixed rate mortgage loans		2,849
Floating rate mortgage loans		298
Total mortgage and other debt	$ 1,482,178	$ 1,504,102
Due within one year	$ 162,478	$ 154,152

Interest costs relating to mortgage and other debt for the three and six months ended June 30, 2003 and 2002, are summarized as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002	2003	2002
	(In thousands)		(In thousands)	
Total interest incurred	$ 21,772	$ 20,735	$ 43,711	$ 40,884
Interest capitalized	(4,608)	(6,554)	(9,726)	(13,901)
Interest expensed	17,164	14,181	33,985	26,983
Less discontinued operations	(15)	(283)	(44)	(541)
Interest expense from continuing operations	$ 17,149	$ 13,898	$ 33,941	$ 26,442

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NOTE 6. PROPERTIES

Book value by property type at June 30, 2003 and December 31, 2002, consisted of the following:

	June 30, 2003	December 31, 2002
	(In thousands)	
Rental properties:		
Industrial buildings	$ 1,167,756	$ 1,134,890
Office buildings	381,090	372,795
Retail buildings	99,066	100,882
Ground leases and other	178,594	176,430
Investment in operating joint ventures	(18,129)	(10,920)
	1,808,377	1,774,077
Developable land:		
Commercial	174,273	171,924
Residential	54,530	52,850
Urban	275,174	279,495
Investment in development joint ventures	60,317	58,071
	564,294	562,340
Work-in-process:		
Commercial	49,434	49,938
Urban	23,992	16,915
	73,426	66,853
Furniture and equipment	38,145	38,096
Other	6,645	6,715
Gross book value	2,490,887	2,448,081
Accumulated depreciation	(427,716)	(399,923)
Net book value	$ 2,063,171	$ 2,048,158

NOTE 7. SEGMENT REPORTING

The Company s reportable segments are based on the Company s method of internal reporting, which disaggregates its business by type and before the adjustments for discontinued operations. The Company has five reportable segments: Asset Management; Suburban, which includes two reportable segments, Commercial and Residential; Urban; and Corporate. The Asset Management segment leases and manages the Company-owned commercial buildings and ground leases. The Suburban Commercial segment develops real estate for the Company s own account or for third parties and acquires and sells developable land and commercial buildings. The Suburban Residential segment acquires and develops suburban residential communities and sells finished lots to homebuilders via direct ownership or through joint ventures. The Urban segment develops major mixed-use sites including development for residential, office, and retail purposes for the Company s own account and for joint ventures, and sells developable land. The Corporate segment consists of administrative services.

Inter-segment gains and losses are not recognized. Debt and interest-bearing assets are allocated to segments based upon the grouping of the underlying assets. All other assets and liabilities are specifically identified and allocated to the segments.

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Financial data by reportable segment is as follows:

Three Months Ended June 30, 2003

	Asset Management	Suburban Commercial	Suburban Residential	Urban	Corporate	Subtotal	Discontinued Operations	Total
				(In thousands)				
Revenue								
Rental revenue	$ 74,455	$	$	$	$	$ 74,455	$ (8)	$ 74,447
Sales revenue	4,390	24,310				28,700	(3,800)	24,900
Management, development and other fees	18	3,057	175	1,613		4,863		4,863
	78,863	27,367	175	1,613		108,018	(3,808)	104,210
Costs and expenses								
Property operating costs	(20,191)					(20,191)	25	(20,166)
Cost of sales	(929)	(20,045)	(140)			(21,114)	833	(20,281)
Selling, general and administrative expenses	(285)	(2,775)	(866)	(1,736)		(5,662)		(5,662)
Corporate administrative costs					(4,505)	(4,505)		(4,505)
Depreciation and amortization	(16,815)	(96)	(29)	(221)	(577)	(17,738)	6	(17,732)
	(38,220)	(22,916)	(1,035)	(1,957)	(5,082)	(69,210)	864	(68,346)
Operating income	40,643	4,451	(860)	(344)	(5,082)	38,808	(2,944)	35,864
Other income								
Equity in earnings of operating joint ventures, net	2,136					2,136		2,136
Equity in earnings of development joint ventures, net			5,427			5,427		5,427
Gain on non-strategic asset sales	1,478					1,478		1,478
Interest income	401	151	676	420	148	1,796		1,796
Other	91	31		(66)	736	792		792
	4,106	182	6,103	354	884	11,629		11,629
Other expenses								
Interest expense	(21,439)				4,275	(17,164)	15	(17,149)
REIT transition costs					(1,805)	(1,805)		(1,805)
Other	(31)	(143)	(1)	138	(159)	(196)		(196)
	(21,470)	(143)	(1)	138	2,311	(19,165)	15	(19,150)
Income (loss) before minority interests, income taxes and discontinued operations	23,279	4,490	5,242	148	(1,887)	31,272	(2,929)	28,343
Minority interests								
Income (loss) before income taxes and discontinued operations	23,279	4,490	5,242	148	(1,887)	31,272	(2,929)	28,343
Income tax (expense) benefit	(8,983)	(1,685)	(2,020)	(52)	722	(12,018)	1,172	(10,846)
Income (loss) from continuing operations	14,296	2,805	3,222	96	(1,165)	19,254	(1,757)	17,497

Discontinued operations, net of tax:								
Gain from disposal of discontinued operations							1,780	1,780
Loss from discontinued operations							(23)	(23)
Net gain from discontinued operations							1,757	1,757
Net income (loss)	$ 14,296	$ 2,805	$ 3,222	$ 96	$ (1,165)	$ 19,254	$	$ 19,254

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Three Months Ended June 30, 2002

	Asset Management	Suburban Commercial	Suburban Residential	Urban	Corporate	Subtotal	Discontinued Operations	Total
	(In thousands)							
Revenue								
Rental revenue	$ 65,279	$	$	$	$	$ 65,279	$ (554)	$ 64,725
Sales revenue	25,360	14,752	20,172			60,284	(16,286)	43,998
Management, development and other fees	26	1,114	169	455		1,764		1,764
	90,665	15,866	20,341	455		127,327	(16,840)	110,487
Costs and expenses								
Property operating costs	(17,391)					(17,391)	199	(17,192)
Cost of sales	(9,417)	(12,481)	(9,760)		(166)	(31,824)	3,657	(28,167)
Selling, general and administrative expenses	(574)	(2,136)	(1,598)	(1,822)		(6,130)		(6,130)
Corporate administrative costs					(4,362)	(4,362)		(4,362)
Depreciation and amortization	(14,299)	(121)	(36)	(226)	(373)	(15,055)	121	(14,934)
	(41,681)	(14,738)	(11,394)	(2,048)	(4,901)	(74,762)	3,977	(70,785)
Operating income	48,984	1,128	8,947	(1,593)	(4,901)	52,565	(12,863)	39,702
Other income								
Equity in earnings of operating joint ventures, net	2,324					2,324		2,324
Equity in earnings of development joint ventures, net			9,597		(1,420)	8,177		8,177
Gain on non-strategic asset sales	7,059					7,059		7,059
Interest income	671	386	1,440	4	55	2,556		2,556
Other	20	(91)	201	(73)	(16)	41		41
	10,074	295	11,238	(69)	(1,381)	20,157		20,157
Other expenses								
Interest expense	(19,135)			5	4,949	(14,181)	283	(13,898)
REIT transition costs								
Other	(64)	(590)	96	142	(336)	(752)		(752)
	(19,199)	(590)	96	147	4,613	(14,933)	283	(14,650)
Income (loss) before minority interests, income taxes and discontinued operations	39,859	833	20,281	(1,515)	(1,669)	57,789	(12,580)	45,209
Minority interests	(1,526)					(1,526)		(1,526)
Income (loss) before income taxes and discontinued operations	38,333	833	20,281	(1,515)	(1,669)	56,263	(12,580)	43,683
Income tax (expense) benefit	(15,416)	(334)	(8,154)	609	671	(22,624)	5,059	(17,565)

Income (loss) from continuing operations	22,917	499	12,127	(906)	(998)	33,639	(7,521)	26,118
Discontinued operations, net of tax:								
Gain from disposal of discontinued operations							7,550	7,550
Loss from discontinued operations							(29)	(29)
Net gain from discontinued operations							7,521	7,521
Net income (loss)	$ 22,917	$ 499	$ 12,127	$ (906)	$ (998)	$ 33,639	$	$ 33,639

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Six Months Ended June 30, 2003

	Asset Management	Suburban Commercial	Suburban Residential	Urban	Corporate	Subtotal	Discontinued Operations	Total
				(In thousands)				
Revenue								
Rental revenue	$ 149,183	$	$	$	$	$ 149,183	$ (616)	$148,567
Sales revenue	29,339	28,308	3,465			61,112	(28,202)	32,910
Management, development and other fees	23	3,881	269	2,774		6,947		6,947
	178,545	32,189	3,734	2,774		217,242	(28,818)	188,424
Costs and expenses								
Property operating costs	(39,780)					(39,780)	180	(39,600)
Cost of sales	(21,123)	(22,376)	(591)			(44,090)	20,837	(23,253)
Selling, general and administrative expenses	(565)	(5,402)	(1,648)	(3,539)		(11,154)		(11,154)
Corporate administrative costs					(8,904)	(8,904)		(8,904)
Depreciation and amortization	(32,646)	(96)	(59)	(487)	(1,149)	(34,437)	145	(34,292)
	(94,114)	(27,874)	(2,298)	(4,026)	(10,053)	(138,365)	21,162	(117,203)
Operating income	84,431	4,315	1,436	(1,252)	(10,053)	78,877	(7,656)	71,221
Other income								
Equity in earnings of operating joint ventures, net	4,659					4,659		4,659
Equity in earnings of development joint ventures, net			9,281			9,281		9,281
Gain on non-strategic asset sales	7,357					7,357		7,357
Interest income	812	305	1,563	643	395	3,718	(5)	3,713
Other	1,161	50			738	1,949		1,949
	13,989	355	10,844	643	1,133	26,964	(5)	26,959
Other expenses								
Interest expense	(42,693)				8,708	(33,985)	44	(33,941)
REIT transition costs					(3,363)	(3,363)		(3,363)
Other	(31)	(143)	(1)	138	(159)	(196)		(196)
	(42,724)	(143)	(1)	138	5,186	(37,544)	44	(37,500)
Income (loss) before minority interests, income taxes and discontinued operations	55,696	4,527	12,279	(471)	(3,734)	68,297	(7,617)	60,680
Minority interests								
Income (loss) before income taxes and discontinued operations	55,696	4,527	12,279	(471)	(3,734)	68,297	(7,617)	60,680
Income tax (expense) benefit	(20,902)	(1,699)	(4,608)	176	1,401	(25,632)	3,047	(22,585)
	34,794	2,828	7,671	(295)	(2,333)	42,665	(4,570)	38,095

Income (loss) from continuing operations								
Discontinued operations, net of tax:								
Gain from disposal of discontinued operations							4,419	4,419
Income from discontinued operations							151	151
Net gain from discontinued operations							4,570	4,570
Net income (loss)	$ 34,794	$ 2,828	$ 7,671	$ (295)	$ (2,333)	$ 42,665	$	$ 42,665

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Six Months Ended June 30, 2002

	Asset Management	Suburban Commercial	Suburban Residential	Urban	Corporate	Subtotal	Discontinued Operations	Total
				(In thousands)				
Revenue								
Rental revenue	$ 128,559	$	$	$	$	$ 128,559	$ (959)	$ 127,600
Sales revenue	35,124	40,990	48,175			124,289	(25,597)	98,692
Management, development and other fees	51	1,663	455	727		2,896		2,896
	163,734	42,653	48,630	727		255,744	(26,556)	229,188
Costs and expenses								
Property operating costs	(33,199)					(33,199)	319	(32,880)
Cost of sales	(11,454)	(36,216)	(24,498)		(516)	(72,684)	5,432	(67,252)
Selling, general and administrative expenses	(710)	(4,085)	(5,766)	(3,419)		(13,980)		(13,980)
Corporate administrative costs					(8,464)	(8,464)		(8,464)
Depreciation and amortization	(26,902)	(275)	(73)	(469)	(887)	(28,606)	257	(28,349)
	(72,265)	(40,576)	(30,337)	(3,888)	(9,867)	(156,933)	6,008	(150,925)
Operating income	91,469	2,077	18,293	(3,161)	(9,867)	98,811	(20,548)	78,263
Other income								
Equity in earnings of operating joint ventures, net	5,845					5,845		5,845
Equity in earnings of development joint ventures, net			17,557		(1,933)	15,624		15,624
Gain on non-strategic asset sales	6,821					6,821		6,821
Interest income	1,344	819	2,866	2	114	5,145		5,145
Other	7,332	633	201			8,166		8,166
	21,342	1,452	20,624	2	(1,819)	41,601		41,601
Other expenses								
Interest expense	(37,883)				10,900	(26,983)	541	(26,442)
REIT transition costs								
Other	(64)	(1,274)	95	142	(344)	(1,445)		(1,445)
	(37,947)	(1,274)	95	142	10,556	(28,428)	541	(27,887)
Income (loss) before minority interests, income taxes and discontinued operations	74,864	2,255	39,012	(3,017)	(1,130)	111,984	(20,007)	91,977
Minority interests	(3,053)					(3,053)		(3,053)
Income (loss) before income taxes and discontinued	71,811	2,255	39,012	(3,017)	(1,130)	108,931	(20,007)	88,924

operations								
Income tax (expense) benefit	(28,880)	(907)	(15,688)	1,213	454	(43,808)	8,046	(35,762)
Income (loss) from continuing operations	42,931	1,348	23,324	(1,804)	(676)	65,123	(11,961)	53,162
Discontinued operations, net of tax:								
Gain from disposal of discontinued operations							12,055	12,055
Loss from discontinued operations							(94)	(94)
Net gain from discontinued operations							11,961	11,961
Net income (loss)	$ 42,931	$ 1,348	$ 23,324	$ (1,804)	$ (676)	$ 65,123	$	$ 65,123

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NOTE 8. COMMITMENTS AND CONTINGENCIES

The Company has surety bonds and standby letters of credit related to various development projects, lease payment guarantees, various debt and debt service guarantees, and capital contribution commitments related to certain unconsolidated real estate joint ventures. These surety bonds, standby letters of credit, guarantees and capital contribution commitments as of June 30, 2003, are summarized in the following categories (in thousands):

Off-balance sheet liabilities:	
Surety bonds	$ 211,939
Standby letters of credit	47,803
Debt service guarantees	53,913
Contribution requirements	14,590
Lease payment guarantee	756
Sub-total	329,001
Liabilities included in balance sheet:	
Standby letters of credit	50,925
Total	$ 379,926

Surety bonds are to guarantee the construction of infrastructure and public improvements as a requirement of entitlement. Surety bonds are commonly required by public agencies from developers in real estate development, are renewable, and expire upon completion of the required improvements. The typical development period of the Company s development projects is approximately one to three years. An example of the type of event that would require the Company to perform under these surety bonds would be the failure of the Company to construct or complete the required improvements. At June 30, 2003, the Company has not been required to fund any of the surety bonds.

Standby letters of credit consist of two types: performance and financial. Performance standby letters of credit are similar in nature and term as the surety bonds described above. Financial standby letters of credit are a form of credit enhancement commonly required in real estate development when bonds are issued to finance public improvements; these financial standby letters of credit are scheduled to expire between December 2005 and May 2007. As of June 30, 2003, the Company has a total of $98.7 million in these standby letters of credit; $47.8 million of the total is off-balance sheet ($40.0 million in financial letters of credit and $7.8 million in performance letters of credit), while the remaining $50.9 million are related to obligations that are reflected in the Company s Condensed Consolidated Balance Sheet ($47.5 million in Mortgage and other debt and $3.4 million in Restricted cash and investments). The $50.9 million of letters of credit were issued as additional security for liabilities already recorded on the balance sheet for separate accounting reasons (primarily assessment bond obligations of assessment districts whose operating boards the Company controls). This is different from the $47.8 million in letters of credit that are related to non-balance sheet items. When the assessment districts are consolidated, the balance sheet is fully consolidated, so there are several corresponding debits, the most significant of which is the associated improvements. An example of the type of event that would require the Company to perform under the performance standby letters of credit would be the failure of the Company to construct or complete the required improvements. An example of the type of event that would require the Company to perform under the financial standby letters of credit would be a debt service shortfall in the municipal district that issued the municipal bonds. At June 30, 2003, the Company has not been required to satisfy any of these standby letters of credit.

The Company has made debt service guarantees for certain of its unconsolidated joint ventures. At June 30, 2003, based on the joint ventures outstanding balance, these debt guarantees totaled $53.9 million. These debt service guarantees are scheduled to expire between January 2004 and September 2005. These debt service guarantees are typical business arrangements commonly required of developers in real estate development. An example of the types of event that would require the Company to provide a cash payment pursuant to a guarantee include a loan default, which would result from failure of the primary borrower to service its debt when due, or non-compliance of the primary borrower with financial covenants or inadequacy of asset collateral. At June 30, 2003, the Company has not been required to satisfy any amounts under these debt service guarantees.

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The Company is required to make additional capital contributions to five of its unconsolidated joint ventures should additional capital contributions be necessary to fund development costs or operating shortfall. The Company agreed with an unconsolidated joint venture to make additional contributions should there be insufficient funds to meet its current or projected financial requirements. As of June 30, 2003, the Company cumulatively contributed $17.3 million to this unconsolidated joint venture, as additional contributions. The Company is also required to make additional capital contributions to another four of its unconsolidated joint ventures should additional capital contributions be necessary (see chart below). As of June 30, 2003, the Company does not expect to fund any additional capital contributions beyond the maximum capital requirements.

	Contribution Committed	Remaining Contribution Commitment
	(In thousands)	
Talega Village, LLC	$ 14,000	$ 5,269
Talega Associates, LLC	20,000	4,773
Parkway Company, LLC	38,000	3,580
Third and King Investors, LLC	25,000	968
	$ 97,000	$ 14,590

Generally, any funding of off-balance sheet guarantees would result in the increase of Catellus ownership interest in a project or entity similar to the treatment of a unilateral additional capital contribution to an investee.

The Company has guaranteed $0.8 million of lease payments through September 2003 of a third party in connection with a development project. As of June 30, 2003, the Company has not been required to satisfy any amounts under this guarantee.

In addition to the contingent liabilities summarized in the table above, the Company also has the following contingencies:

The Company has recorded in its consolidated balance sheet $0.9 million estimated residual home warranty related liability from home-building activities prior to the selling of its home-building assets in 2000. The estimate is based on past claims and experience. These home warranty related reserves are charged to cost of sales when established.

As of June 30, 2003, $163.3 million of Community Facility District bonds were sold to finance public infrastructure improvements at several Company projects. The Company provided letters of credit totaling $40.0 million in support of some of these bonds. The $40.0 million is included in the standby letters of credit and surety bonds amounts disclosed above. The Company, along with other landowners, is required to satisfy any shortfall in annual debt service obligation for these bonds if incremental tax revenues generated by the projects are insufficient.

The Company is a party to a number of legal actions arising in the ordinary course of business. The Company cannot predict with certainty the final outcome of these proceedings. Considering current insurance coverages and the substantial legal defenses available, however, management believes that none of these actions, when finally resolved, will have a material adverse effect on the consolidated financial conditions, results of operations, or cash flows of the Company. Where appropriate, the Company has established reserves for potential liabilities related to legal actions or threatened legal actions. These reserves are necessarily based on estimates and probabilities of the occurrence of events and therefore are subject to revision from time to time.

Some of the legal actions to which the Company is party seek to restrain actions related to the development process or challenge title to or possession of the Company s properties. Typically, such actions, if successful, would not result in significant financial liability for the Company but might instead prevent the completion of the development process originally planned, and therefore, impairment may occur in certain development assets.

Inherent in the operations of the real estate business is the possibility that environmental liability may arise from the current or past ownership, or current or past operation, of real properties. The Company may be required in the future to take action to correct or reduce the environmental effects of prior disposal or release of hazardous substances by third parties, the Company, or its corporate predecessors. Future environmental costs are difficult to estimate because of such factors as the unknown magnitude of possible contamination, the unknown timing and extent of the corrective actions that may be required, the determination of the Company s potential liability in proportion to that of other potentially responsible parties, and the extent to which such costs are recoverable from insurance. Also, the Company does not generally have access to properties sold by it in the past.

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At June 30, 2003, management estimates that future costs for remediation of environmental contamination on operating properties and properties previously sold approximate $9.1 million, and has provided a reserve for that amount. It is anticipated that such costs will be incurred over the next several years. Management also estimates approximately $12.0 million of similar costs relating to the Company s properties to be developed or sold. The Company may incur additional costs related to management of excess contaminated soil from our projects; however, the necessity of this activity depends on the type of future development activities, and, therefore, the related costs are not currently determinable. These costs will be capitalized as components of development costs when incurred, which is anticipated to be over a period of approximately twenty years, or will be deferred and charged to cost of sales when the properties are sold. Environmental costs capitalized during the six months ended June 30, 2003, totaled $1.0 million. The Company s estimates were developed based on reviews that took place over several years based upon then-prevailing law and identified site conditions. Because of the breadth of its portfolio, and past sales, the Company is unable to review each property extensively on a regular basis. Such estimates are not precise and are always subject to the availability of further information about the prevailing conditions at the site, the future requirements of regulatory agencies, and the availability and ability of other parties to pay some or all of such costs.

NOTE 9. RELATED PARTY TRANSACTIONS

The entities below are considered related parties because the listed transactions are with entities in which the Company has an ownership interest. There are no affiliated persons involved with these entities.

The Company provides development and management services and loan guarantees to various unconsolidated joint venture investments. Fees earned were $1.9 million and $3.3 million for the three and six months ended June 30, 2003, respectively, of which $1.6 million and $2.8 million, respectively, were from Third and King Investors, LLC, with the remainder primarily from Traer Creek LLC, Serrano Associates, LLC, and Talega Village, LLC. Fees earned were $0.8 million and $1.1 million for the three and six months ended June 30, 2002, respectively, of which $0.5 million and $0.7 million, respectively, were from Third and King Investors, LLC, with the remainder primarily from Traer Creek LLC and Talega Village, LLC. Deferred fees primarily from Traer Creek LLC and Serrano Associates, LLC of $1.6 million at June 30, 2003, will be earned as completed projects are sold or the venture is sold or liquidated.

In 2001, the Company entered into a 99-year ground lease with one of its unconsolidated joint venture investments, Third and King Investors, LLC. Rent payments of $0.9 million were received and recognized as rental income during each of the three months ended June 30, 2003 and 2002 and $1.8 million in each of the six months ended June 30, 2003 and 2002. Rent payments of $1.3 million of previously received rent were deferred at June 30, 2003, and will be recognized, together with annual rents, over the life of the lease.

The Company has a $4.5 million collateralized 9.0% note receivable from an unconsolidated joint venture, East Baybridge Partners, LP, for project costs plus accrued interest. The note is collateralized by property owned by the venture and matures in October 2028. The Company entered into various lease agreements with this unconsolidated joint venture. As lessee, rent expense was $34,000 in each of the three-month periods ended June 30, 2003 and 2002 and $68,000 for each of the six-month periods ended June 30, 2003 and 2002; this lease will expire in November 2011. As lessor, the Company entered into a ground lease, which will expire in August 2054. The Company earned rental income of $0.1 million in each of the three-month periods ended June 30, 2003 and 2002, and $0.2 million for each of the six-month periods ended June 30, 2003 and 2002, and recorded a $2.0 million receivable associated with this lease.

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NOTE 10. DISCONTINUED OPERATIONS

In general, sales of rental property are classified as discontinued operations. Therefore, income or loss attributed to the operations and sale of rental properties sold or held for sale is presented in the statement of operations as discontinued operations, net of applicable income taxes. Prior period statements of operations have been reclassified to reflect as discontinued operations the income or loss related to rental properties that were sold or held for sale and presented as discontinued operations during the period up to June 30, 2003. Additionally, all periods presented will likely require further reclassification in future periods as additional, similar sales of rental properties occur.

Discontinued operations activities for the three and six months ended June 30, 2003 and 2002 are summarized as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	**2002**	**2003**	**2002**
	(In thousands)			
Gain from disposal of discontinued operations				
Sales revenue	$ 3,800	$ 16,286	$ 28,202	$ 25,597
Cost of sales	(833)	(3,657)	(20,837)	(5,432)
	2,967	12,629	7,365	20,165
Income tax expense	(1,187)	(5,079)	(2,946)	(8,110)
Net gain	$ 1,780	$ 7,550	$ 4,419	$ 12,055
Rental Revenue	$ 8	$ 554	$ 616	$ 959
Income (loss) from discontinued operations	$ (38)	$ (49)	$ 252	$ (158)
Income tax (expense) benefit	15	20	(101)	64
Net income (loss)	$ (23)	$ (29)	$ 151	$ (94)

Asset and liability balances of rental properties under contract to be sold at December 31, 2002 (none at June 30, 2003), consist of the following:

	December 31, 2002
	(In thousands)
Assets	
Properties	$ 3,216
Accumulated depreciation	(744)
Net	2,472
Other assets	288
Total assets	2,760
Liabilities	
Mortgage and other debt	3,147
Payables	62
Other liabilities	24
Total liabilities	3,233

Net liabilities	$	473

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NOTE 11. REAL ESTATE INVESTMENT TRUST (REIT) CONVERSION

On March 3, 2003, the Company announced that its Board of Directors has authorized it to restructure its business operations in order to qualify as a real estate investment trust (REIT), effective January 1, 2004. The REIT conversion is subject to a stockholder approval process, which is expected to conclude in the third quarter of 2003, as well as final Board approval. This announcement has no material effect on the financial statements, except for $1.8 million and $3.4 million of transition costs, which relates to the REIT conversion and was incurred and expensed during three and six months ended June 30, 2003, respectively; however, it will likely have an impact on future operating results in the following areas, if approved by the stockholder vote:

- a one-time distribution of pre-REIT earnings and profits, projected to be approximately $100 million in cash and $200 million in common stock, will be declared and paid in the fourth quarter; certain aspects of this distribution are subject to ruling by the Internal Revenue Service
- commencing after the third quarter of 2003, a quarterly dividend of approximately $0.30 per existing share of common stock will be paid
- conversion and related restructure costs are currently estimated to be $7.5 million
- one-time costs associated with the proposed stock option exchange offer estimated at $30 million to be recognized over three years
- certain deferred tax liabilities associated with assets in the REIT would be reversed through income and result in a one-time increase in income currently estimated in the $200 to $250 million range

Catellus SubCo, Inc., a wholly owned subsidiary, has filed a preliminary proxy statement/prospectus with the Securities and Exchange Commission that provides important information, including detailed risk factors, regarding the proposed REIT conversion.

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

The Company:

Catellus Development Corporation is a publicly traded real estate development company that owns and operates approximately 37.4 million square feet of predominantly industrial property in many of the country s major distribution centers and transportation corridors. The company s principal objective is sustainable, long-term growth in earnings, which it seeks to achieve by applying its strategic resources: a lower-risk/higher-return rental portfolio, a focus on expanding that portfolio through development, and the deployment of its proven land development skills to select opportunities where it can generate profits to recycle back into its business. More information on the company is available at www.catellus.com.

Recent Developments

On March 3, 2003, we announced that our Board of Directors (Board) has authorized us to restructure our business operations to qualify as a real estate investment trust, effective January 1, 2004, subject to stockholder and Board approvals. We have spent the past several years successfully transforming what was one of the country s largest land portfolios into predominantly industrial rental property and capital that has been reinvested back into our business. We are now embarking upon a transition period to restructure our operations and change our business strategy to focus increasingly on industrial development and to reduce focus on other product types.

In anticipation of the REIT conversion, we will take steps during 2003 to better position our businesses for operation as a REIT. This will include looking for ways to operate more efficiently, consistent with a focus of new development on industrial product. We plan to continue our Urban mixed use projects that are underway, but do not plan to seek new ones. Since the Urban Group (*see* Urban Group below) will no longer be pursuing new activities, and given the considerable progress made on existing projects, it is also anticipated that the scope of activities will be reduced, resulting in a reduction in work force over 2003 and 2004. It is anticipated that Doug Gardner, President, and Mark Schuh, Executive Vice President, both of the Urban Group, will continue to lead their group during the transition for the balance of 2003, after which they will leave Catellus. The Urban Group currently reports to the chief executive officer of Catellus, and this reporting relationship will continue. The Urban Group projects will be operated in a taxable REIT subsidiary (TRS), and we expect to recycle surplus capital from the Urban Group projects through continuing development with greater emphasis on third party parcel sales, land leases, and joint ventures. During 2003, the Suburban Residential Group (*see* Suburban Residential Group below) projects will be positioned for sale and any remaining assets will be operated in a TRS upon REIT conversion.

We plan to present the REIT conversion to our stockholders for approval at our annual meeting, which is expected to be held in the third quarter of 2003. If the REIT conversion is consummated, Catellus will operate as an umbrella partnership real estate investment trust, with wholly-owned taxable REIT subsidiaries. As part of the REIT conversion, we will provide to stockholders a one-time distribution of pre-REIT earnings and profits, in compliance with the requirements to elect REIT status. Furthermore, subject to final Board approval, we anticipate that we will begin paying a quarterly dividend commencing with a payment of $0.30 per common share for the third quarter of 2003. Catellus SubCo, Inc., a wholly owned subsidiary, filed a Form S-4 registration statement, which contains a preliminary proxy statement/prospectus, with the Securities and Exchange Commission on May 2, 2003, as amended by Amendment No. 1, Amendment No. 2, and Amendment No. 3, filed on June 17, 2003, July 28, 2003, and August 12, 2003, respectively. The preliminary proxy statement/prospectus provides important information, including detailed risk factors, regarding the proposed REIT conversion. A copy of the preliminary proxy statement/prospectus and other relevant documents are available free of charge at the SEC s website (www.sec.gov) or can be obtained free of charge by directing a request to us at 201 Mission Street, Second Floor, San Francisco, California 94105, Attn.: Director of Investor Relations, or by telephone at (415) 974-4649, or by email at InvestorRelations@catellus.com or through our website (www.Catellus.com) as soon as reasonably practicable after such material is electronically filed with or furnished to the Securities and Exchange Commission. There is no assurance that the proposed REIT conversion will be consummated or that the terms of the REIT conversion or the timing or effects thereof will not differ materially from those described in the preliminary proxy statement/prospectus and other relevant documents.

General

Our reportable segments are based on our method of internal reporting, which disaggregates our business by type and before the adjustments for discontinued operations. We have five reportable segments: Asset Management; Suburban, which includes two reportable segments, Commercial and Residential; Urban; and Corporate.

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Business Segment Descriptions:

Asset Management:

The Asset Management segment consists of the rental activities of our assets, our share of income from operating joint ventures, and activity related to our desert portfolio. Growth in this segment is attributed primarily to the transfer of property developed by the Suburban Commercial and Urban segments that we intend to hold and operate. Revenue consists of rental property operations and gains from the sale of rental properties (*see* Note 10 of the accompanying Condensed Consolidated Financial Statements for a discussion of discontinued operations).

Rental Building Occupancy:

	June 30, 2003	June 30, 2002	Difference
	(In thousands of square feet, except percentages)		
Owned [1]	37,403	34,498	2,905
Occupied [1]	35,298	32,510	2,788
Occupancy percentage	94.4%	94.2%	0.2%

[1] New buildings are added to our rental portfolio at the earlier of twelve months after completion of the building shell or commencement of rent on 50% of the space. Space is considered occupied upon commencement of rent.

The table below provides the rental portfolio rental revenue less property operating costs for the three months ended June 30, 2003, (in thousands):

Rental Revenue less Property Operating Costs by State

	Industrial: Rental Revenue less Property Operating Expenses	Industrial: % of Total	Office: Rental Revenue less Property Operating Expenses	Office: % of Total	Retail: Rental Revenue less Property Operating Expenses	Retail: % of Total	Total: Rental Revenue less Property Operating Expenses	Total: % of Total
Southern California	$ 12,964	23.0%	$ 1,362	2.4%	$ 644	1.1%	$ 14,970	26.5%
Northern California	7,579	13.4%	5,146	9.1%	1,627	2.9%	14,352	25.4%
Illinois	5,288	9.4%	1,220	2.2%		0.0%	6,508	11.5%
Texas	2,458	4.4%	1,700	3.0%		0.0%	4,158	7.4%
Colorado	2,428	4.3%	919	1.6%	254	0.5%	3,601	6.4%
Arizona	690	1.2%		0.0%	181	0.3%	871	1.5%
Maryland	772	1.4%		0.0%		0.0%	772	1.4%
Oregon	656	1.2%	140	0.2%	99	0.2%	895	1.6%
Ohio	590	1.0%		0.0%		0.0%	590	1.0%
Other	363	0.6%		0.0%		0.0%	363	0.6%
Subtotal	$ 33,788	59.9%	$ 10,487	18.6%	$ 2,805	5.0%	$ 47,080	83.5%
Ground leases and other							5,176	9.2%
Other properties							2,008	3.6%
							54,264	
							2,136	3.8%

Equity in earnings of operating JV s			
Total	$	56,400	100.0%
Less: discontinued operations		17	
Rental revenue less property operating costs from continuing operations	$	56,417	

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The table below provides the rental portfolio by square feet by State as of June 30, 2003 (In thousands).

	Industrial		Office		Retail		Total	
	Square Feet	% of Total	Square Feet	% of Total	Square Feet	% of Total	Square Feet	% of Total
Southern California	11,988	32.4%	574	1.5%	176	0.5%	12,738	34.0%
Northern California	5,773	15.4%	808	2.2%	481	1.2%	7,062	18.9%
Illinois	6,268	16.8%	584	1.6%		0.0%	6,852	18.3%
Texas	3,264	8.7%	869	2.3%		0.0%	4,133	11.0%
Colorado	2,353	6.3%	273	0.7%	100	0.3%	2,726	7.3%
Arizona	1,123	3.0%		0.0%	74	0.2%	1,197	3.2%
Ohio	966	2.6%		0.0%		0.0%	966	2.6%
Oregon	545	1.5%	57	0.2%	37	0.1%	639	1.7%
Maryland	471	1.3%		0.0%		0.0%	471	1.3%
Other	619	1.7%		0.0%		0.0%	619	1.7%
Total	33,370	89.2%	3,165	8.5%	868	2.3%	37,403	100.0%

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Suburban Commercial:

The Suburban Commercial segment acquires and develops suburban commercial business parks for our own account and the account of others. Net income consists primarily of sales gains from development properties sold and construction management, developer, and other fees.

The table below provides the development potential of our Suburban Commercial land portfolio:

Project Name	City/Location	June 30, 2003 (1)
		Square feet (In thousands)
Southern California		
Kaiser Commerce Center	San Bernardino County	2,147
Crossroads Business Park	Ontario	2,016
Rancho Pacific Distribution Centre	Rancho Cucamonga	312
San Bernardino	San Bernardino	865
Pacific Center	Anaheim	44
Subtotal Southern Calif.		5,384
Northern California		
Pacific Commons	Fremont	3,576
Duck Creek	Stockton	2,000
Alameda FISC (controlled)	Alameda	1,300
Spreckels Business Park	Manteca	686
Regatta Business Park	Richmond	89
Subtotal Northern Calif.		7,651
Total California		13,035
Illinois		
Minooka	Minooka	3,393(2)
Internationale Centre	Woodridge	976
Prairie Glen Corporate Campus	Glenview	437(3)
Joliet	Joliet	402
International Centre West	Romeoville	17
Subtotal Illinois		5,225
Texas		
Hobby Business Park	Houston	1,700
Gateway Corporate Center	Coppell	1,120
Stellar Way Business Park	Grand Prairie	814
Gateway East Business Park	Garland	763
Plano	Plano	403
Ft. Worth	Ft. Worth	104
Subtotal Texas		4,904
Other		
Eastgate	Aurora, CO	4,000
Stapleton Business Park	Denver, CO	750
South Shore Corp. Park	Gresham/Portland, OR	765
Circle Point Corporate Center	Westminster, CO	685

Cedar Grove Business Park	Louisville, KY	545
Douglas Hill Business Park	Atlanta, GA	294
Ford Winchester	Winchester, VA	189
Subtotal Other		7,228
Total Outside California		17,357
Total Suburban Commercial Inventory		30,392

(1) All entitled, except for 1,327,000 square feet included in Crossroads Business Park in which entitlement is in progress.
(2) Excluded from this balance is approximately 2.8 million square feet under option.
(3) Included in this balance is 335,000 square feet that is under option.

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Suburban Residential:

The Suburban Residential segment acquires and develops land primarily for single-family residential property, via direct investment or through joint ventures, and sells finished lots to homebuilders. This segment also owns an interest in a joint venture that develops senior housing. As part of the REIT conversion, we anticipate the level of activities in the Suburban Residential segment will decrease.

The table below provides the development potential, by lots/homes, of our Suburban Residential land portfolio.

	Ownership Interest	Lots/Units at June 30, 2003
Colorado		
Vista Range, Commerce City	100%	2,149(1)
Northern California		
Alameda (2)	100%	485
Hercules	100%	1(3)
Serrano, Sacramento	50%	1,150
Parkway, Sacramento (multi-family)	50%	538
		2,174
Southern California		
Talega Seniors, San Clemente	50%	2
Talega, San Clemente	30%	967
West Bluffs, Playa del Rey (4)	100%	114
		1,083
Total		5,406

(1) As of June 30, 2003, these lots were sold for $23.2 million. The sale was 100% deferred because of inadequate down payment received to meet the criteria for revenue recognition.

(2) Of the 485 lots, we own 190 and have options on 295 lots.

(3) A commercial site.

(4) We have entitlements for this project; however, the entitlements are being challenged under the California Environmental Quality Act and the California Coastal Act (*see* Legal Proceedings section).

Urban:

The Urban segment entitles and develops urban mixed-use sites in San Francisco, Los Angeles, and San Diego. The principal project of the segment is Mission Bay in San Francisco.

As discussed in the Recent Developments section, as part of the REIT conversion, we plan to continue our Urban mixed-use projects that are currently underway, but do not plan to seek new ones. As such, it is anticipated that the scope of activities will be reduced over the next several years.

The table below provides the entitled development potential by square feet, of our Urban land portfolio:

	R&D, Biotech & Office	CBD Office	Retail/ Entertainment	Residential	Hotel

	(Net Rentable Sq. Ft.)			(Units)	(Rooms)
Mission Bay (SF, CA)	4,537,000		548,000	3,263	500
Union Station (LA, CA)		5,175,000	675,000		
Santa Fe Depot (SD, CA)		440,000	270,000	710	
Total	4,537,000	5,615,000	1,493,000	3,973	500

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Corporate:

Corporate consists primarily of administrative costs and interest contra-expense. Corporate interest (contra-expense) represents required capitalized interest, on qualifying assets in the Suburban and Urban segments, in excess of interest directly incurred by these segments. As these qualifying assets are sold, the corresponding capitalized interest is reflected as cost of sales in the Corporate segment or, for those assets transferred to Asset Management, as the assets are placed in service the corresponding interest capitalized is added to the cost basis of the asset and depreciated over the life of the building.

Critical Accounting Policies

Our discussion and analysis of financial condition and results of operations is based on our Condensed Consolidated Financial Statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of our Condensed Consolidated Financial Statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to revenue and cost of sales recognition, impairment of real estate assets, capitalization of costs, allowance for doubtful accounts, environmental and legal reserves, and income taxes. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting policies reflect our more significant judgments and estimates used in the preparation of the Condensed Consolidated Financial Statements.

Revenue recognition

Our revenue is primarily derived from two sources: rental revenue from our rental portfolio and property sales. Rental revenue is recognized when due from tenants. Revenue from leases with rent concessions or fixed escalations is recognized on a straight-line basis over the initial term of the related lease. The financial terms of leases are contractually defined. Rental revenue is not accrued when a tenant vacates the premises and ceases to make rent payments or files for bankruptcy.

Revenue from sales of properties is recognized using the accrual method. If a sale does not qualify for the accrual method of recognition, deferral methods are used as appropriate including the percentage-of-completion method. In certain cases, we retain the right to repurchase property from the buyer at a specified price. These sales are not recognized until our right to repurchase expires. In other instances, when we receive an inadequate cash down payment and take a promissory note for the balance of the sale prices, sale is deferred until such time as sufficient cash is received to meet minimum down payment requirements. Also, in general, specific identification and relative sales value methods are used to determine the cost of sales. A change in circumstances that causes the estimate of future costs to increase or decrease significantly would affect the gain or loss recognized on future sales.

Impairment of real estate assets

We assess the impairment of a real estate asset when events or changes in circumstances indicate that the net book value may not be recoverable. Indicators we consider important which could trigger an impairment review include the following:

- significant negative industry or economic trend;
- a significant underperformance relative to historical or projected future operating results;
- a significant change in the manner in which an asset is used; and
- an accumulation of costs significantly in excess of the amount originally expected to construct an asset.

Real estate is stated at the lower of cost or estimated fair value using the methodology described as follows: (a) for operating properties and properties held for investment, a write-down to estimated fair value is recognized when a property s estimated undiscounted future cash flow is less than its net book value; and (b) for properties held for sale, a write-down to estimated fair value is recorded when we determine that the net book value exceeds the estimated selling price less cost to sell. These evaluations are made on a property-by-property basis. When we determine that the net book value of an asset may not be recoverable based upon the estimated undiscounted cash flow, we measure any impairment write-down based on a projected discounted cash flow method using an estimated market discount rate. When performing an impairment review, we consider capitalized interest and other expenses as costs of development in costs projections and the value from comparable property sales. The evaluation of future cash flows, discount rates, and fair value of individual properties requires significant judgment and assumptions, including estimates of market value, lease terms, development absorption, development costs, lease up costs, and financings. Significant adverse changes in circumstances affecting these judgments and assumptions in future periods could cause a significant impairment adjustment to be recorded.

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Capitalization of costs

We capitalize direct construction and development costs, including predevelopment costs, property taxes, insurance, and certain indirect project costs, including a portion of our general and administrative costs that are associated with the acquisition, development, or construction of a project. Interest is capitalized in accordance with FAS 34. Costs previously capitalized related to any abandoned development opportunities are written off. Should development activity decrease, a portion of interest, property taxes, insurance, and certain general and administrative costs would no longer be eligible for capitalization and would be expensed as incurred.

Allowance for doubtful accounts

We make estimates with respect to the collectability of our receivables and provide for doubtful accounts based on several factors, including our estimate of collectability and the age of the outstanding balances. Our estimate of collectability is based on our contacts with the debtors, collection agencies, our knowledge of the debtors credit and financial condition, debtors payment terms, and current economic trends. If a debtor becomes insolvent or files for bankruptcy, we provide an allowance for the entire outstanding amount of the debtors receivable. Significant judgments and estimates must be made and used in connection with establishing allowances in any accounting period. Material differences may result in the amount and timing of our allowances for any period if adverse general economic conditions cause widespread financial difficulties among our tenants.

Environmental and legal reserves

We incur ongoing environmental remediation costs, including clean up costs, consulting fees for environmental studies and investigations, monitoring costs, and legal costs relating to clean up, litigation defense, and the pursuit of responsible third parties. We maintain a reserve for estimated costs of environmental remediation to be incurred in connection with operating properties and properties previously sold; these reserves, when established, are expensed. Costs relating to undeveloped land are capitalized as part of development costs, and costs incurred for properties to be sold are deferred and charged to cost of sales when the properties are sold; these costs are anticipated to be incurred over a period of twenty years. Our estimates are developed based on reviews that took place over many years based upon then-prevailing law and identified site conditions. Because of the breadth of our portfolio, and past sales, we are unable to review each property extensively on a regular basis. Such estimates are not precise and are always subject to the availability of further information about the prevailing conditions at the site, the future requirements of regulatory agencies, and the availability and ability of other parties to pay some or all of such costs. Should a previously undetected, substantial environmental hazard be found on our properties, significant liquidity could be consumed by the resulting clean up requirements, and a material expense may be recorded.

We are a party to a number of legal actions arising in the ordinary course of business. We cannot predict with certainty the final outcome of the proceedings. Where appropriate, we have established reserves for potential liabilities related to legal actions or threatened legal actions. Environmental and legal reserves are established based on estimates and probabilities of the occurrence of events and therefore are subject to revision from time to time. Should the circumstances affecting these estimates change significantly, a material expense would be recognized.

Income taxes

As part of the process of preparing our Condensed Consolidated Financial Statements, significant management judgment is required to estimate our income taxes. Our estimates are based on interpretation of tax laws. We estimate our actual current tax due and assess temporary differences resulting from differing treatment of items for tax and accounting purposes. The temporary differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheet. Adjustments may be required by a change in assessment of our deferred tax assets and liabilities, changes due to audit adjustments by Federal and State tax authorities, and changes in tax laws. To the extent adjustments are required in any given period we would include the adjustments within the tax provision in the statement of operations and/or balance sheet. Any applicable interest charges would be recorded as an expense. These adjustments could materially impact our statement of operations and liquidity.

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Financial Condition and Results of Operations

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the Condensed Consolidated Financial Statements and related Notes appearing elsewhere in this Form 10-Q. This discussion and analysis covers our five business segments: Asset Management; Suburban, which includes a Commercial and Residential division; Urban; and Corporate.

Below is a summary of net income by segment for the Three Months Ended June 30, 2003:

		Suburban						
	Asset Management	Commercial	Residential	Urban	Corporate	Subtotal	Discontinued Operations	Total
					(In thousands)			
Revenue								
Rental revenue	$ 74,455	$	$	$	$	$ 74,455	$ (8)	$ 74,447
Sales revenue	4,390	24,310				28,700	(3,800)	24,900
Management, development and other fees	18	3,057	175	1,613		4,863		4,863
	78,863	27,367	175	1,613		108,018	(3,808)	104,210
Costs and expenses								
Property operating costs	(20,191)					(20,191)	25	(20,166)
Cost of sales	(929)	(20,045)	(140)			(21,114)	833	(20,281)
Selling, general and administrative expenses	(285)	(2,775)	(866)	(1,736)		(5,662)		(5,662)
Corporate administrative costs					(4,505)	(4,505)		(4,505)
Depreciation and amortization	(16,815)	(96)	(29)	(221)	(577)	(17,738)	6	(17,732)
	(38,220)	(22,916)	(1,035)	(1,957)	(5,082)	(69,210)	864	(68,346)
Operating Income	40,643	4,451	(860)	(344)	(5,082)	38,808	(2,944)	35,864
Other income								
Equity in earnings of operating joint ventures, net	2,136					2,136		2,136
Equity in earnings of development joint ventures, net			5,427			5,427		5,427
Gain on non-strategic asset sales	1,478					1,478		1,478
Interest income	401	151	676	420	148	1,796		1,796
Other	91	31		(66)	736	792		792
	4,106	182	6,103	354	884	11,629		11,629
Other expenses								
Interest expense	(21,439)				4,275	(17,164)	15	(17,149)
REIT transition costs					(1,805)	(1,805)		(1,805)
Other	(31)	(143)	(1)	138	(159)	(196)		(196)
	(21,470)	(143)	(1)	138	2,311	(19,165)	15	(19,150)
Income before minority interests, income taxes and	23,279	4,490	5,242	148	(1,887)	31,272	(2,929)	28,343

discontinued operations								
Minority interests								
Income before income taxes and discontinued operations	23,279	4,490	5,242	148	(1,887)	31,272	(2,929)	28,343
Income tax	(8,983)	(1,685)	(2,020)	(52)	722	(12,018)	1,172	(10,846)
Income from continuing operations	14,296	2,805	3,222	96	(1,165)	19,254	(1,757)	17,497
Discontinued operations, net of tax:								
Gain from disposal of discontinued operations							1,780	1,780
Loss from discontinued operations							(23)	(23)
Net gain from discontinued operations							1,757	1,757
Net income (loss)	$ 14,296	$ 2,805	$ 3,222	$ 96	$ (1,165)	$ 19,254	$	$ 19,254

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Below is a summary of net income by segment for the Three Months Ended June 30, 2002:

	Asset Management	Suburban Commercial	Suburban Residential	Urban	Corporate	Subtotal	Discontinued Operations	Total
	(In thousands)							
Revenue								
Rental revenue	$ 65,279	$	$	$	$	$ 65,279	$ (554)	$ 64,725
Sales revenue	25,360	14,752	20,172			60,284	(16,286)	43,998
Management, development and other fees	26	1,114	169	455		1,764		1,764
	90,665	15,866	20,341	455		127,327	(16,840)	110,487
Costs and expenses								
Property operating costs	(17,391)					(17,391)	199	(17,192)
Cost of sales	(9,417)	(12,481)	(9,760)		(166)	(31,824)	3,657	(28,167)
Selling, general and administrative expenses	(574)	(2,136)	(1,598)	(1,822)		(6,130)		(6,130)
Corporate administrative costs					(4,362)	(4,362)		(4,362)
Depreciation and amortization	(14,299)	(121)	(36)	(226)	(373)	(15,055)	121	(14,934)
	(41,681)	(14,738)	(11,394)	(2,048)	(4,901)	(74,762)	3,977	(70,785)
Operating Income	48,984	1,128	8,947	(1,593)	(4,901)	52,565	(12,863)	39,702
Other income								
Equity in earnings of operating joint ventures, net	2,324					2,324		2,324
Equity in earnings of development joint ventures, net			9,597		(1,420)	8,177		8,177
Gain on non-strategic asset sales	7,059					7,059		7,059
Interest income	671	386	1,440	4	55	2,556		2,556
Other	20	(91)	201	(73)	(16)	41		41
	10,074	295	11,238	(69)	(1,381)	20,157		20,157
Other expenses								
Interest expense	(19,135)			5	4,949	(14,181)	283	(13,898)
REIT transition costs								
Other	(64)	(590)	96	142	(336)	(752)		(752)
	(19,199)	(590)	96	147	4,613	(14,933)	283	(14,650)
Income before minority interests, income taxes and discontinued operations	39,859	833	20,281	(1,515)	(1,669)	57,789	(12,580)	45,209
Minority interests	(1,526)					(1,526)		(1,526)
Income before income taxes and discontinued operations	38,333	833	20,281	(1,515)	(1,669)	56,263	(12,580)	43,683
Income tax	(15,416)	(334)	(8,154)	609	671	(22,624)	5,059	(17,565)
	22,917	499	12,127	(906)	(998)	33,639	(7,521)	26,118

Income from continuing operations								
Discontinued operations, net of tax:								
Gain from disposal of discontinued operations							7,550	7,550
Loss from discontinued operations							(29)	(29)
Net gain from discontinued operations							7,521	7,521
Net income (loss)	$ 22,917	$ 499	$ 12,127	$ (906)	$ (998)	$ 33,639	$	$ 33,639

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Below is a summary of net income by segment for the Six Months Ended June 30, 2003:

	Asset Management	Suburban Commercial	Suburban Residential	Urban	Corporate	Subtotal	Discontinued Operations	Total
	(In thousands)							
Revenue								
Rental revenue	$ 149,183	$	$	$	$	$ 149,183	$ (616)	$ 148,567
Sales revenue	29,339	28,308	3,465			61,112	(28,202)	32,910
Management, development and other fees	23	3,881	269	2,774		6,947		6,947
	178,545	32,189	3,734	2,774		217,242	(28,818)	188,424
Costs and expenses								
Property operating costs	(39,780)					(39,780)	180	(39,600)
Cost of sales	(21,123)	(22,376)	(591)			(44,090)	20,837	(23,253)
Selling, general and administrative expenses	(565)	(5,402)	(1,648)	(3,539)		(11,154)		(11,154)
Corporate administrative costs					(8,904)	(8,904)		(8,904)
Depreciation and amortization	(32,646)	(96)	(59)	(487)	(1,149)	(34,437)	145	(34,292)
	(94,114)	(27,874)	(2,298)	(4,026)	(10,053)	(138,365)	21,162	(117,203)
Operating Income	84,431	4,315	1,436	(1,252)	(10,053)	78,877	(7,656)	71,221
Other income								
Equity in earnings of operating joint ventures, net	4,659					4,659		4,659
Equity in earnings of development joint ventures, net			9,281			9,281		9,281
Gain on non-strategic asset sales	7,357					7,357		7,357
Interest income	812	305	1,563	643	395	3,718	(5)	3,713
Other	1,161	50			738	1,949		1,949
	13,989	355	10,844	643	1,133	26,964	(5)	26,959
Other expenses								
Interest expense	(42,693)				8,708	(33,985)	44	(33,941)
REIT transition costs					(3,363)	(3,363)		(3,363)
Other	(31)	(143)	(1)	138	(159)	(196)		(196)
	(42,724)	(143)	(1)	138	5,186	(37,544)	44	(37,500)
Income before minority interests, income taxes and discontinued operations	55,696	4,527	12,279	(471)	(3,734)	68,297	(7,617)	60,680
Minority interests								
Income before income taxes and discontinued operations	55,696	4,527	12,279	(471)	(3,734)	68,297	(7,617)	60,680
Income tax	(20,902)	(1,699)	(4,608)	176	1,401	(25,632)	3,047	(22,585)

Income from continuing operations	34,794	2,828	7,671	(295)	(2,333)	42,665	(4,570)	38,095
Discontinued operations, net of tax:								
Gain from disposal of discontinued operations							4,419	4,419
Income from discontinued operations							151	151
Net gain from discontinued operations							4,570	4,570
Net income (loss)	$ 34,794	$ 2,828	$ 7,671	$ (295)	$ (2,333)	$ 42,665	$	$ 42,665

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Below is a summary of net income by segment for the Six Months Ended June 30, 2002:

	Asset Management	Suburban Commercial	Suburban Residential	Urban	Corporate	Subtotal	Discontinued Operations	Total
				(In thousands)				
Revenue								
Rental revenue	$ 128,559	$	$	$	$	$ 128,559	$ (959)	$ 127,600
Sales revenue	35,124	40,990	48,175			124,289	(25,597)	98,692
Management, development and other fees	51	1,663	455	727		2,896		2,896
	163,734	42,653	48,630	727		255,744	(26,556)	229,188
Costs and expenses								
Property operating costs	(33,199)					(33,199)	319	(32,880)
Cost of sales	(11,454)	(36,216)	(24,498)		(516)	(72,684)	5,432	(67,252)
Selling, general and administrative expenses	(710)	(4,085)	(5,766)	(3,419)		(13,980)		(13,980)
Corporate administrative costs					(8,464)	(8,464)		(8,464)
Depreciation and amortization	(26,902)	(275)	(73)	(469)	(887)	(28,606)	257	(28,349)
	(72,265)	(40,576)	(30,337)	(3,888)	(9,867)	(156,933)	6,008	(150,925)
Operating Income	91,469	2,077	18,293	(3,161)	(9,867)	98,811	(20,548)	78,263
Other income								
Equity in earnings of operating joint ventures, net	5,845					5,845		5,845
Equity in earnings of development joint ventures, net			17,557		(1,933)	15,624		15,624
Gain on non-strategic asset sales	6,821					6,821		6,821
Interest income	1,344	819	2,866	2	114	5,145		5,145
Other	7,332	633	201			8,166		8,166
.	21,342	1,452	20,624	2	(1,819)	41,601		41,601
Other expenses								
Interest expense	(37,883)				10,900	(26,983)	541	(26,442)
REIT transition costs								
Other	(64)	(1,274)	95	142	(344)	(1,445)		(1,445)
	(37,947)	(1,274)	95	142	10,556	(28,428)	541	(27,887)
Income before minority interests, income taxes and discontinued operations	74,864	2,255	39,012	(3,017)	(1,130)	111,984	(20,007)	91,977
Minority interests	(3,053)					(3,053)		(3,053)
Income before income taxes and discontinued operations	71,811	2,255	39,012	(3,017)	(1,130)	108,931	(20,007)	88,924
Income tax	(28,880)	(907)	(15,688)	1,213	454	(43,808)	8,046	(35,762)

Income from continuing operations	42,931	1,348	23,324	(1,804)	(676)	65,123	(11,961)	53,162
Discontinued operations, net of tax:								
Gain from disposal of discontinued operations							12,055	12,055
Loss from discontinued operations							(94)	(94)
Net gain from discontinued operations							11,961	11,961
Net income (loss)	$ 42,931	$ 1,348	$ 23,324	$ (1,804)	$ (676)	$ 65,123	$	$ 65,123

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Variance Three Months Ended June 30, 2003 vs Three Months Ended June 30, 2002:

	Asset Management	Suburban Commercial	Suburban Residential	Urban	Corporate	Subtotal	Discontinued Operations	Total
			(In thousands)					
Revenue								
Rental revenue	$ 9,176	$	$	$	$	$ 9,176	$ 546	$ 9,722
Sales revenue	(20,970)	9,558	(20,172)					