

PRICE ENTERPRISES INC  
Form 10-Q  
May 15, 2001

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

**FORM 10-Q**

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

For the quarter ended March 31, 2001

Commission file Number 0-20449

**PRICE ENTERPRISES, INC.**

(Exact name of registrant as specified in its charter)

|   |  |
|---|--|
| <b>Maryland</b><br>(State or other jurisdiction of<br>incorporation or organization)  | <b>33-0628740</b><br>(I.R.S. Employer<br>Identification No.) |
| <b>17140 Bernardo Center Drive, Suite 300, San Diego, California 92128</b><br>(Address of principal executive offices) (Zip Code) |  |

**(858) 675-9400**

(Registrant's telephone number, including area code)

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 //

The registrant had 13,309,006 shares of common stock, par value \$.0001 per share, outstanding at May 14, 2001.

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**PRICE ENTERPRISES, INC.**

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**PART I FINANCIAL INFORMATION**

**ITEM 1 FINANCIAL STATEMENTS (UNAUDITED)**

**PRICE ENTERPRISES, INC.**

**CONSOLIDATED BALANCE SHEETS**

(in thousands)

**ASSETS**

|  | <b>March 31<br/>2001</b> | <b>December 31<br/>2000</b> |
|--|--------------------------|-----------------------------|
|  | <b>(unaudited)</b>       | <b>(Note)</b>               |
| Real estate assets                       |                          |                             |
| Land and land improvements               | \$ 273,939               | \$ 247,470                  |
| Building and improvements                | 301,673                  | 302,915                     |
| Fixtures and equipment                   | 887                      | 856                         |
| Construction in progress                 | 5,848                    | 4,436                       |
|  | <u>582,347</u>           | <u>555,677</u>              |
| Less accumulated depreciation            | (12,024)                 | (9,877)                     |
|  | <u>570,323</u>           | <u>545,800</u>              |
| Investment in real estate joint ventures | 16,019                   | 14,515                      |
| Cash and cash equivalents                | 26,587                   | 49,996                      |
| Accounts receivable                      | 3,627                    | 3,032                       |
| Note receivable from affiliate           | 39,782                   | 25,377                      |
| Notes receivable                         | 13,898                   | 13,388                      |
| Deferred rents                           | 3,934                    | 3,352                       |
| Other assets                             | 8,650                    | 6,945                       |

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|   | March 31<br>2001 | December 31<br>2000 |
|---|------------------|---------------------|
| Total assets                                | \$ 682,820       | \$ 662,405          |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b> |                  |                     |
| Liabilities                                 |                  |                     |
| Mortgages and notes payable                 | \$ 150,591       | \$ 150,709          |
| Revolving line of credit                    | 63,400           | 44,300              |
| Accounts payable and other liabilities      | 4,594            | 4,287               |
| Total liabilities                           | 218,585          | 199,296             |
| Commitments                                 |                  |                     |
| Stockholders' equity                        |                  |                     |
| Series A preferred stock                    | 353,404          | 353,404             |
| Common stock                                | 1                | 1                   |
| Additional paid-in capital                  | 113,332          | 112,587             |
| Accumulated deficit                         | (2,502)          | (2,883)             |
| Total stockholders' equity                  | 464,235          | 463,109             |
| Total liabilities and stockholders' equity  | \$ 682,820       | \$ 662,405          |

Note: The balance sheet at December 31, 2000 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements.

See accompanying notes.

PRICE ENTERPRISES, INC.

CONSOLIDATED STATEMENTS OF INCOME

(unaudited amounts in thousands, except per share data)

|                               | First Quarter<br>Three Months Ended<br>March 31 |           |
|-------------------------------|---|-----------|
|                               | 2001  | 2000      |
| Rental revenues               | \$ 17,781                                       | \$ 17,471 |
| Expenses                      |   |           |
| Operating and maintenance     | 2,303   | 1,788     |
| Property taxes                | 2,141   | 2,118     |
| Depreciation and amortization | 2,226   | 2,289     |
| General and administrative    | 867   | 775       |

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|   | First Quarter<br>Three Months Ended<br>March 31 |         |
|---|---|---------|
|   | 2001  | 2000    |
| Total expenses                                | 7,537   | 6,970   |
| Operating income                              | 10,244  | 10,501  |
| Interest and other                            |   |         |
| Interest expense                              | (3,398)   | (1,749) |
| Interest income                               | 1,846   | 361     |
| Equity in earnings of joint ventures          | 138   | 58      |
| Total interest and other                      | (1,414)   | (1,330) |
| Income before loss on sale of real estate     | 8,830   | 9,171   |
| Loss on sale of real estate                   | (91)  |         |
| Net income                                    | 8,739   | 9,171   |
| Dividends paid to preferred stockholders      | (8,358)   | (8,324) |
| Net income applicable to common stockholders  | \$ 381  | \$ 847  |
| Basic and diluted net income per common share | \$ .03  | \$ .06  |
| Weighted average common shares outstanding    |   |         |
| Basic and diluted                             | 13,309  | 13,309  |
| Dividends per preferred share                 | \$ .35  | \$ .35  |

See accompanying notes.

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**PRICE ENTERPRISES, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(unaudited amounts in thousands)

|   | First Quarter<br>Three Months Ended<br>March 31 |          |
|---|---|----------|
|   | 2001  | 2000     |
| Operating activities  |   |          |
| Net income  | \$ 8,739  | \$ 9,171 |
| Adjustments to reconcile net income to net cash provided by operating activities: |   |          |
| Depreciation and amortization   | 2,226   | 2,289    |

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|  | First Quarter<br>Three Months Ended<br>March 31 |           |
|--|---|-----------|
| Deferred rents   | (582)   | (832)     |
| Equity in earnings of joint venture                      | (138)   | (58)      |
| Loss on sale of real estate                              | 91  |           |
| Changes in operating assets and liabilities:             |   |           |
| Accounts receivable and other assets                     | (2,341)   | (3,369)   |
| Accounts payable and other liabilities                   | 307   | 1,532     |
| Net cash provided by operating activities                | 8,302   | 8,733     |
| Investing activities                                     |   |           |
| Additions to real estate assets                          | (28,306)  | (13,325)  |
| Proceeds from the sale of real estate assets             | 1,507   |           |
| Contributions to real estate joint ventures              | (1,366)   | (48)      |
| Advances on notes receivable                             | (17,600)  | (7,805)   |
| Repayments on notes receivable                           | 2,685   |           |
| Net cash used in investing activities                    | (43,080)  | (21,178)  |
| Financing activities                                     |   |           |
| Advances from revolving line of credit and notes payable | 19,100  | 22,800    |
| Repayments of revolving line of credit and notes payable | (118)   | (3,025)   |
| Dividends paid   | (8,358)   | (8,324)   |
| Proceeds from exercise of stock options                  | 745   | 230       |
| Net cash provided by financing activities                | 11,369  | 11,681    |
| Net decrease in cash and cash equivalents                | (23,409)  | (764)     |
| Cash and cash equivalents at beginning of period         | 49,996  | 2,145     |
| Cash and cash equivalents at end of period               | \$ 26,587                                       | \$ 1,381  |
| Supplemental cash flow information:                      |   |           |
| Cash paid for interest (net of amount capitalized)       | \$ 3,119  | \$ 1,224  |
| Supplemental schedule of noncash financing activities:   |   |           |
| Assumption of loans to acquire real estate assets        | \$  | \$ 14,686 |

See accompanying notes.

PRICE ENTERPRISES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

March 31, 2001

Note 1 Organization and Significant Accounting Policies

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### Organization

Price Enterprises, Inc. (PEI) operates as a real estate investment trust (REIT) incorporated in the state of Maryland. Our principal business is to own, acquire, operate, manage and lease real property, primarily open-air shopping centers. We became a REIT in September 1997 after we spun-off our merchandising segment and certain other assets to PriceSmart, Inc. In November 1999 Excel Legacy Corporation (Legacy) completed its exchange offer for our common stock. In the exchange offer, Legacy acquired approximately 91.3% of our common stock, which represents approximately 77.5% of PEI's voting power.

In accounting for this transaction, we followed Accounting Principles Board Opinion No. 16, "Business Combinations," which requires we treat this transaction as a purchase. In following purchase accounting, we allocated the cost basis of Legacy's investment in our common stock among our assets and liabilities to adjust them to fair value at the time of the completion of the exchange offer.

### Accounting Principles

We prepared the financial statements following the requirements of the Securities and Exchange Commission (SEC) for interim reporting. As permitted under those rules, certain footnotes or other financial information that are normally required by accounting principles generally accepted in the United States (GAAP) can be omitted. Certain prior year data have been reclassified to conform to the 2001 presentation.

We are responsible for the unaudited financial statements included in this document. The financial statements include all normal and recurring adjustments that are considered necessary for the fair presentation of our financial position and operating results. You should also read the financial statements and notes in our latest annual report on Form 10-K, as amended.

Revenues, expenses, assets and liabilities can vary during each quarter of the year. Therefore, the results and trends in these interim financial statements may not be the same as those for the full year.

### Real Estate Assets and Depreciation

Prior to Legacy's exchange offer for our common stock, we recorded real estate assets at historical costs, and adjusted them for recognition of impairment losses. In following purchase accounting, we adjusted the historical costs of our real estate assets to fair value. Our consolidated balance sheets at March 31, 2001 and December 31, 2000 reflect the new basis of our real estate assets.

We expense ordinary repairs and maintenance as incurred; we capitalize major replacements and betterments and depreciate them over their estimated useful lives.

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Following completion of Legacy's exchange offer for our common stock, we adopted Legacy's accounting policy of depreciating real estate assets. We compute real estate asset depreciation on a straight-line basis over their estimated useful lives, as follows:

|                           |                           |
|---------------------------|---------------------------|
| Land improvements         | 40 years                  |
| Building and improvements | 40 years                  |
| Tenant improvements       | Term of lease or 10 years |
| Fixtures and equipment    | 3-7 years                 |

We capitalize interest incurred during the construction period of certain assets and this interest is depreciated over the lives of those assets. The following table shows interest expense and the amount capitalized (amounts in thousands):

|                      | Three Months Ended<br>March 31 |          |
|----------------------|--------------------------------|----------|
|                      | 2001                           | 2000     |
| Interest incurred    | \$ 3,838                       | \$ 2,192 |
| Interest capitalized | 440                            | 443      |

### Use of Estimates

Preparing financial statements in conformity with accounting principles generally accepted in the United States requires that we make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. We continually review our

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estimates and make adjustments as necessary, but actual results could differ from what we envisioned when we made these estimates.

### *New Accounting Standards*

In 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) No. 133, "Accounting for Derivative Instruments and Hedging Activities," and in 1999 they voted to delay the effective date of this SFAS by one year. SFAS No. 133 establishes a new model for accounting for derivatives and hedging activities, where all derivatives must be recognized as assets and liabilities and measured at fair value. We adopted this standard on January 1, 2001 and it did not have a significant impact on our financial statements.

### **Note 2 Net Income Per Share**

In 1997, the Financial Accounting Standards Board issued SFAS No. 128, "Earnings Per Share." SFAS No. 128 requires presentation of two calculations of earnings per common share. Basic earnings per common share equals net income applicable to common stockholders divided by weighted average common shares outstanding during the period. Diluted earnings per common share equals net income applicable to common stockholders divided by the sum of weighted average common shares outstanding during the period plus common stock equivalents. Common stock equivalents are shares assumed to be

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issued if outstanding stock options that are dilutive were exercised. We did not have any common stock equivalents during the periods presented.

### **Note 3 Real Estate Assets**

#### **Acquisitions**

During the first quarter of 2001, we purchased land in Walnut Creek, CA for \$2.8 million to be used for the future development of a self storage facility. Also during the first quarter we purchased land in Anaheim, CA for \$23.3 million to be used for future development. In conjunction with the purchase of the Anaheim land, we executed a ground lease agreement with Legacy. The lease has a term of 50 years and requires payments of \$2.8 million per year in rent. We used the proceeds from tax-deferred exchange transactions on properties we sold in 2000 to fund both acquisitions.

During the first quarter of 2000, we acquired the following properties:

| <b>Location</b>               | <b>Description</b> | <b>Date Acquired</b> | <b>Purchase Price (000's)</b> | <b>Mortgage Assumed (000's)</b> |
|-------------------------------|--------------------|----------------------|-------------------------------|---------------------------------|
| Middletown, OH                | Retail building    | 2/9/00               | \$ 6,709                      | \$ 3,726                        |
| Terre Haute, IN               | Retail building    | 2/9/00               | 5,762                         | 3,598                           |
| San Diego/Rancho Bernardo, CA | Office building(1) | 2/25/00              | 16,025                        | 11,025(2)                       |

(1) *Property leased back to Legacy*

(2) *Indicates maximum construction loan balance. Balance assumed on date of acquisition was \$7.4 million.*

We purchased the properties from Legacy and we funded these acquisitions through advances on our unsecured revolving credit facility.

#### **Disposition**

During the first quarter of 2001, we sold a property in Aurora, CO for \$1.5 million. We are using the proceeds from the sale to purchase additional properties in tax-deferred exchange transactions.

There were no dispositions during the first quarter of 2000.

**Note 4 Notes Receivable**

In March 2000, we executed a \$15 million note receivable with Legacy due December 2002. The note was amended to allow Legacy to borrow up to \$40.0 million on the note. The note bears an interest rate of LIBOR plus 375 basis points (8.9% at March 31, 2001) on the first \$15.0 million. Amounts borrowed in excess of \$15 million bear interest at a fixed rate of 12.5% per year. As of March 31, 2001, Legacy owed \$39.8 million on this note at a weighted average interest rate of 11.1%.

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We also have \$13.9 million in notes receivable outstanding at March 31, 2001 related to various development projects. The notes bear interest at 11% to 25% per year and are secured by the related projects. The notes mature on various dates through December 2001.

**Note 5 Debt**

In June 2000, we borrowed \$121.4 million from GMAC Commercial Mortgage Corporation. The GMAC loan is secured by five retail properties located in Westbury, NY; Signal Hill, CA; Philadelphia, PA; Wayne, NJ; and Roseville, CA. The GMAC loan bears interest at LIBOR plus 98 basis points, 6.25% at March 31, 2001, and is due on June 28, 2004. We used proceeds of the loan to repay outstanding amounts on our existing revolving credit facility.

In connection with our GMAC loan, we reduced the existing revolving credit facility from \$125 million of total availability to \$75 million of total availability. The amended facility matures December 2001 with current interest rates of LIBOR plus 140 to 185 basis points. The rate varies based on our leverage, amounts loaned to Legacy, and other financial ratios. As of March 31, 2001, we owed \$63.4 million on this credit facility at a weighted average interest rate of 7.0%.

We have a capital lease arrangement totaling \$11.5 million at March 31, 2001 in conjunction with the San Diego/Rancho Bernardo, CA office building. The obligation matures in December 2004.

We also have mortgages on four properties totaling \$17.8 million. The loans bear interest ranging from 7.6% to 9.0% and are secured by the properties. The loans mature on various dates ranging from June 2003 to March 2014.

**Note 6 Related Party Transactions**

Following Legacy's completion of its exchange offer, Legacy took over daily management of PEI, including property management, finance and administration. We reimburse Legacy for these services. We expensed \$0.8 million for these services during the first quarter of 2001, which was based on our historical costs for similar expenses.

During the first quarter of 2001 we recorded \$0.9 million in interest income from Legacy related to the note receivable discussed in Note 4.

In conjunction with the San Diego/Rancho Bernardo, CA office building purchase from Legacy discussed in Note 3, we leased the building back to Legacy under a 10-year lease agreement. During the first quarter of 2001, we recorded \$0.2 million of rental revenue from Legacy in connection with this lease.

In conjunction with the purchase of the Anaheim land discussed in Note 3, we executed a ground lease agreement with Legacy. The lease has a term of 50 years and requires payments of \$2.8 million per year in rent. During the first quarter of 2001 we recorded \$0.5 million in rental revenue from Legacy related to this lease.

We discuss other related party transactions with Legacy in Note 3, Note 4, Note 5, Note 7 and Note 8.

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**Note 7 Significant Event**

On March 21, 2001, PEI, PEI Merger Sub, Inc., a Maryland corporation (Merger Sub), and Legacy entered into an Agreement and Plan of Merger (the Merger Agreement). Pursuant to the Merger Agreement and subject to the terms and conditions set forth therein, Merger Sub will be merged with and into Legacy (the Merger), with Legacy continuing as a wholly-owned subsidiary of PEI. At the effective time of the Merger, each outstanding share of Legacy common stock, will be exchanged for 0.6667 of a share of PEI common stock, and each option to purchase



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shares of Legacy common stock will be exchanged for an option to purchase shares of PEI common stock (with the exercise price and number of shares appropriately adjusted to reflect the exchange ratio). Following the Merger, PEI will continue to operate as a real estate investment trust under the name Price Legacy Corporation (Price Legacy). The Merger, which is structured to qualify as a tax-free reorganization, is subject to the approval of the stockholders of both PEI and Legacy and other customary closing conditions.

Also on March 21, 2001, PEI entered into a Securities Purchase Agreement (the Securities Purchase Agreement) with Warburg, Pincus Equity Partners, L.P. and certain of its affiliates (Warburg Pincus), pursuant to which PEI agreed to sell to Warburg Pincus (a) 17,985,612 shares of a new class of preferred stock, 9% Series B Junior Convertible Redeemable Preferred Stock, par value \$0.0001 per share (the Series B Preferred Stock), and (b) a warrant (the Warrant) to purchase an aggregate of 2.5 million shares of Price Legacy common stock at an exercise price of \$8.25 per share, for an aggregate purchase price of \$100,000,000. The Series B Preferred Stock is junior to the Series A Preferred Stock with respect to dividend, liquidation and other rights, and is convertible under certain conditions into Price Legacy common stock at \$5.56 per share after 24 months from the date of issuance. The 9% coupon will be paid in kind with additional shares of Series B Preferred Stock for the first 45 months from issuance. Since the Warburg Pincus investment and the Merger are subject to substantially the same conditions, it is expected that the two transactions will close concurrently (assuming they are both completed).

On April 12, 2001, PEI and Sol Price, a significant stockholder of PEI and Legacy through various trusts, agreed to convert an existing Legacy loan payable to a trust controlled by Sol Price of approximately \$9.3 million into 1,681,142 shares of the Series B Preferred Stock and a warrant to purchase 233,679 shares of our common stock at an exercise price of \$8.25 per share concurrently with the closing of the merger with Legacy and the sale of the Series B Preferred Stock to Warburg Pincus. These transactions are subject to stockholder approval and other customary conditions.

### **Note 8 Subsequent Events**

In May 2001, we agreed in principle to master lease our existing four self-storage properties to certain of our officers, including Kelly D. Burt, Executive Vice President Development, and William J. Hamilton, Senior Vice President Self Storage. Effective as of the date of the agreement, the officers ceased being employees of PEI and Legacy. The initial rent paid under this agreement will be \$5.1 million per year. As part of the agreement, we will have the right to require the lessee to purchase the properties from us at a price based upon the properties' net operating income as defined by the agreement. In addition, we intend to develop four additional self-storage properties that the lessees will have the right to acquire from us upon completion and stabilization of the properties. The final terms of the transaction are subject to the negotiation and execution of a definitive agreement, and other

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customary closing conditions. No assurance can be given that the transaction will be completed on the terms described above or at all.

On May 14, 2001, PEI, Swerdlow Real Estate Group, Inc. (Swerdlow) and entities affiliated with Swerdlow entered into a Purchase and Sale Agreement effective as of May 7, 2001 (the Purchase Agreement). Subject to the terms and conditions set forth in the Purchase Agreement, PEI has the right to acquire from Swerdlow and its affiliates up to six properties located in Florida for aggregate consideration of \$282.2 million, subject to adjustment, including the assumption of mortgage indebtedness. The properties are primarily retail centers that contain an aggregate of approximately 2.8 million square feet of gross leasable area. As of May 14, 2001, five properties were operating and approximately 97% leased to approximately 250 tenants and one property was under development. Major tenants include Home Depot, Kmart, Target, Winn-Dixie, BJ's Wholesale Club and Regal Cinemas. The transaction is subject to satisfactory completion of PEI's due diligence investigation of the properties, approval of the Swerdlow board of directors, and other customary closing conditions. If the necessary conditions are satisfied, the transaction is expected to be completed in the third quarter of 2001. However, no assurance can be given that the transaction will be completed on the terms described in the Purchase Agreement or in this paragraph or at all.

A copy of the Purchase Agreement is attached as Exhibit 10.1 hereto and incorporated herein by reference. The foregoing description is qualified in its entirety by reference to the full text of such Exhibit.

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

### ***Introduction***

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Our disclosure and analysis in this report contain "forward-looking statements." Forward-looking statements give our current expectations or forecasts of future events. You can identify these statements by the fact that they do not relate strictly to historic or current facts. They use words such as "anticipate," "estimate," "expect," "project," "intend," "plan," "believe," and other words and terms of similar meaning in connection with any discussion of future operating or financial performance. From time to time, we also may provide oral or written forward-looking statements in other materials we release to the public. Any or all of our forward-looking statements in this report and in any other public statements we make may turn out to be incorrect. They can be affected by inaccurate assumptions we might make or by known or unknown risks and uncertainties. Consequently, no forward-looking statement can be guaranteed. Actual results may vary materially.

We undertake no obligation to publicly update any forward-looking statements, whether as a result of new information, future events or otherwise. You are advised, however, to consult any further disclosures we make on related subjects in our reports on Forms 10-K, 10-Q and 8-K filed with the SEC. Our Form 10-K filing for the 2000 fiscal year listed various important factors that could cause actual results to differ materially from expected and historic results.

We note these factors for investors as permitted by the Private Securities Litigation Reform Act of 1995. Readers can find them in Part I of our 2000 Form 10-K under the heading "Factors That May Affect Future Performance." You should understand that it is not possible to predict or identify all such factors. Consequently, you should not consider any such list to be a complete set of all potential risks or uncertainties.

In Management's Discussion and Analysis we explain our general financial condition and results of operations including:

why revenues, costs and earnings changed from the prior period

funds from operations (FFO)

how we used cash for capital projects and dividends and how we expect to use cash in 2001

where we plan on obtaining cash for future dividend payments and future capital expenditures

As you read Management's Discussion and Analysis, it may be helpful to refer to our financial statements and accompanying notes beginning on page 3. In Management's Discussion and Analysis we explain the changes in specific line items in the statements of income. Where changes are due to more than one reason, we list the reasons in order of importance.

### ***Rental Revenues***

|                  | <u>Amount</u> | <u>Change</u> | <u>Percent<br/>Change</u> |
|------------------|---------------|---------------|---------------------------|
| 1st Quarter 2001 | \$ 17,781     | \$ 310        | 2%                        |
| 1st Quarter 2000 | 17,471        |               |                           |

Revenues increased \$0.3 million to \$17.8 million in the first quarter of 2001 compared to the same period in 2000 primarily because:

properties we acquired during 2000 and the first quarter of 2001 generated \$1.1 million of additional revenues

revenue from properties we owned in 2000 and 2001 increased \$0.6 million

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partially offsetting these increases were revenues from properties we sold in 2000, which contributed \$1.4 million of revenues in the first quarter of 2000

### ***Expenses***

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|                  | <u>Amount</u> | <u>Change</u> | <u>Percent Change</u> |
|------------------|---------------|---------------|-----------------------|
| 1st Quarter 2001 | \$ 7,537      | \$ 567        | 1%                    |
| 1st Quarter 2000 | 6,970         |               |                       |

Expenses increased \$0.6 million to \$7.5 million in the first quarter of 2001 compared to 2000 primarily because:

expenses from properties we owned in both 2000 and 2001 increased by \$0.2 million

expansion of our self storage business which increased expenses by \$0.4 million

bad debt expense increased \$0.5 million in 2001 compared to 2000, primarily due to a recovery of amounts previously written off from a former tenant in 2000

these increases in expenses were partially offset by properties we sold in 2000 which contributed an additional \$0.5 million to expenses in the first quarter of 2000

**Operating Income**

|                  | <u>Amount</u> | <u>Change</u> | <u>Percent Change</u> |
|------------------|---------------|---------------|-----------------------|
| 1st Quarter 2001 | \$ 10,244     | \$ (257)      | -2%                   |
| 1st Quarter 2000 | 10,501        |               |                       |

Operating income decreased for the first quarter of 2001 compared to the same periods in the prior year primarily because of the changes in Rental Revenues and Expenses discussed above.

**Interest Expense**

|                  | <u>Amount</u> | <u>Change</u> | <u>Percent Change</u> |
|------------------|---------------|---------------|-----------------------|
| 1st Quarter 2001 | \$ 3,398      | \$ 1,649      | 94%                   |
| 1st Quarter 2000 | 1,749         |               |                       |

Interest expense increased \$1.6 million in the first quarter of 2001 compared to 2000 because during the first quarter of 2001 we had an average of \$208.2 million of debt outstanding compared to \$111.2 million in the first quarter of 2000. We discuss our outstanding debt further in "Liquidity and Capital Resources" located elsewhere in this Form 10-Q.

**Interest Income**

|                  | <u>Amount</u> | <u>Change</u> | <u>Percent Change</u> |
|------------------|---------------|---------------|-----------------------|
| 1st Quarter 2001 | \$ 1,846      | \$ 1,485      | 411%                  |
| 1st Quarter 2000 | 361           |               |                       |

Interest income increased \$1.5 million in the first quarter of 2001 compared to the same period in 2000 primarily because:

our note receivable with Legacy earned interest of \$0.9 million

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our notes receivable from other developers and other interest-bearing receivables earned additional interest of \$0.3 million

we recorded an additional \$0.3 million in interest income on higher cash balances in 2001

### Funds From Operations

|   | Three Months<br>Ended March 31 |          |
|---|--------------------------------|----------|
|   | 2001                           | 2000     |
| Net income                                    | \$ 8,739                       | \$ 9,171 |
| Depreciation and amortization                 | 2,226                          | 2,289    |
| PEI's share of depreciation of joint ventures | 259                            | 15       |
| Loss on sale of real estate                   | 91                             |          |
| Funds from operations (FFO)                   | 11,315                         | 11,475   |
| Preferred dividends paid                      | (8,358)                        | (8,324)  |
| FFO attributable to common shareholders       | \$ 2,957                       | \$ 3,151 |

Real estate industry analysts typically use FFO as another measurement of performance for real estate-oriented companies. In general, FFO adjusts net income for noncash charges such as depreciation, amortization and most non-recurring gains and losses. The National Association for Real Estate Investment Trusts (NAREIT), defines FFO as net income, excluding depreciation and amortization expense, and gains (losses) from certain sales of property.

FFO during the first quarter of 2001 decreased 1.4% to \$11.3 million compared to the first quarter of 2000 primarily because of the changes in revenues and expenses discussed previously. In the fourth quarter of 2000, we sold \$24.3 million of operating properties. The proceeds of these properties were deposited in tax-deferred exchange accounts until we are able to reinvest the proceeds into new properties. At March 31, 2001, the balance held in tax-deferred exchange accounts was \$22.8 million. The contribution from interest earned on the tax-deferred exchange accounts was approximately \$0.3 million less than the FFO earned in 2000 on the related operating properties sold.

FFO does not represent the accounting principles generally accepted in the United States definition of cash flows from operations and should not be considered as an alternative to net income as an indicator of our operating performance or to cash flows as a measure of liquidity. Net cash provided by operations (see accompanying Consolidated Statements of Cash Flows) was \$8.3 million for the first quarter of 2001 and \$8.7 million for the first quarter of 2000.

### Liquidity and Capital Resources

Liquidity refers to our ability to generate sufficient cash flows to meet the short and long-term cash requirements of our business operations. Capital resources represent those funds used or available to be used to support our business operations and consist of stockholders' equity and debt.

Cash flow from operations has been the principal source of capital to fund our ongoing operations and dividend payments, while use of our credit facility and mortgage financing have been the principal sources of capital required to fund our growth. While we are positioned to finance our business activities through a variety of sources, we expect to satisfy short-term liquidity requirements through net cash provided by operations and through borrowings.

We continue to evaluate various properties for acquisition or development, which has included acquiring development properties from Legacy once completed. We also continue to evaluate other investment opportunities. In 2001 we anticipate borrowing available amounts on our credit facility to

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fund these acquisition and development opportunities. We are also seeking additional funds through issuing new equity. We anticipate obtaining construction loans to fund our development activities. During the first quarter of 2001 we purchased two properties for future development for \$26.0 million. We used the proceeds from tax-deferred exchange transactions on properties sold in 2000 to fund these acquisitions. We are also under contract to buy and are contemplating buying additional properties.

From time to time we will consider selling properties to better align our portfolio with our geographic and tenant composition strategies. We may also participate in additional tax-deferred exchange transactions, which allow us to dispose of properties and reinvest the proceeds in a tax efficient manner. During the first quarter we sold one property from our portfolio for \$1.5 million. We anticipate a temporary reduction in operating income due to the time lag between selling a property and reinvesting the proceeds. We are also under contract to sell and are contemplating selling certain other properties.

These potential purchases and sales may not be completed due to uncertainties associated with contract negotiations and buyer due diligence contingencies.

In June 2000 we borrowed \$121.4 million from GMAC Commercial Mortgage Corporation. The GMAC loan is secured by five retail properties located in Westbury, NY; Signal Hill, CA; Philadelphia, PA; Wayne, NJ; and Roseville, CA. The GMAC loan bears interest at LIBOR plus 98 basis points, 6.25% at March 31, 2001, and is due in June 2004. We used proceeds of the loan to repay outstanding amounts on our existing revolving credit facility.

In connection with our GMAC loan, we reduced our existing revolving credit facility from \$125 million of total availability to \$75 million of total availability. The amended facility has a remaining term of one year with interest rates of LIBOR plus 140 to 185 basis points. The rate varies based on our leverage, amounts loaned to Legacy, and other financial ratios. As of March 31, 2001, we owed \$63.4 million on this credit facility at a weighted average interest rate of 7.01%.

### **Inflation**

Because a substantial number of our leases contain provisions for rent increases based on changes in various consumer price indices, fixed rate increases, or percentage rent if tenant sales exceed certain base amounts, we do not expect inflation to have a material impact on future net income or cash flow from developed and operating properties. In addition, substantially all leases are triple net, which means specific operating expenses and property taxes are passed through to the tenant.

### **ITEM 3 QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Market risks relating to our operations result primarily from changes in short-term LIBOR interest rates. We do not have any foreign exchange or other significant market risk, nor did we have any derivative financial instruments at March 31, 2001.

Our exposure to market risk for changes in interest rates relates primarily to our unsecured revolving credit facility and GMAC loan. We enter into fixed rate mortgages and variable rate debt obligations to support general corporate purposes, including acquisitions, capital expenditures and working capital needs. We continuously evaluate our level of variable rate debt with respect to total debt and other factors, including our assessment of the current and future economic environment.

We had \$184.8 million in variable rate debt outstanding at March 31, 2001. Based upon this debt level, a hypothetical 10% adverse change in interest rates would increase interest expense by approximately \$1.2 million on an annual basis, and likewise decrease our earnings and cash flows. We cannot predict market fluctuations in interest rates and their impact on our variable rate debt, nor can there be any assurance that fixed rate long-term debt will be available to us at favorable rates, if at all. Consequently, future results may differ materially from the estimated adverse changes discussed above.

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## **PART II OTHER INFORMATION**

### **ITEM 5 OTHER INFORMATION**

On May 14, 2001, PEI, Swerdlow Real Estate Group, Inc. (Swerdlow) and entities affiliated with Swerdlow entered into a Purchase and Sale Agreement effective as of May 7, 2001 (the Purchase Agreement). Subject to the terms and conditions set forth in the Purchase Agreement, PEI

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has the right to acquire from Swerdlow and its affiliates up to six properties located in Florida for aggregate consideration of \$282.2 million, subject to adjustment, including the assumption of mortgage indebtedness. The properties are primarily retail centers that contain an aggregate of approximately 2.8 million square feet of gross leasable area. As of May 14, 2001, five properties were operating and approximately 97% leased to approximately 250 tenants and one property was under development. Major tenants include Home Depot, Kmart, Target, Winn-Dixie, BJ's Wholesale Club and Regal Cinemas. The transaction is subject to satisfactory completion of PEI's due diligence investigation of the properties, approval of the Swerdlow board of directors, and other customary closing conditions. If the necessary conditions are satisfied, the transaction is expected to be completed in the third quarter of 2001. However, no assurance can be given that the transaction will be completed on the terms described in the Purchase Agreement or in this paragraph or at all.

A copy of the Purchase Agreement is attached as Exhibit 10.1 hereto and incorporated herein by reference. The foregoing description is qualified in its entirety by reference to the full text of such Exhibit.

**ITEM 6 EXHIBITS AND REPORTS ON FORM 8-K**

a)

The following exhibits are included herein or incorporated by reference:

10.1\* Purchase and Sale Agreement, dated as of May 7, 2001, among SREG Operating Limited Partnership, SREG Oakwood Plaza, Inc., SREG OBC, Inc., SREG Hollywood Hills, Inc., SREG Cypress Creek, Inc., SREG Kendale, Inc., SREG Cross County, Inc., SREG (Millenia), Inc., Swerdlow Real Estate Group, Inc. and Price Enterprises, Inc.

\*

Filed herewith.

A request for confidential treatment with respect to portions of this exhibit have been omitted (indicated by asterisks) pursuant to Rule 24b-2 under the Securities Exchange Act of 1934 is currently pending.

(b)

Reports on Form 8-K during the quarter

We filed a report on Form 8-K on March 23, 2001 relating to the merger agreement with Legacy. We did not file any other reports on Form 8-K during the quarter ended March 31, 2001.

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PRICE ENTERPRISES, INC.  
*Registrant*

Date: May 14, 2001

/s/ GARY B. SABIN

Gary B. Sabin  
*President & Chief Executive Officer*

Date: May 14, 2001

/s/ JAMES Y. NAKAGAWA

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James Y. Nakagawa  
Chief Financial Officer  
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