TAYLOR DEVICES INC
Form 10QSB
April 13, 2006

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10 QSB

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

For quarter ended February 28, 2006

Commission File Number 0 3498

TAYLOR DEVICES, INC.
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

NEW YORK	16 0797789
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

90 TAYLOR DRIVE, NORTH TONAWANDA, NEW YORK 14120-0748
Address of principal executive offices

716 694 0800
Registrant's Telephone Number

Check whether the registrant (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the last 12 months and (2) has been subject to the filing requirements for the past 90 days.

Yes X No ___

Indicate by checkmark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.

Yes ___ No X

State the number of shares outstanding of each of the Issuer's classes of common equity, as of the latest practicable date:

CLASS	Outstanding at April 13, 2006
Common Stock (2 1/2 cents par value)	3,126,002

TAYLOR DEVICES, INC.

Index to Form 10-QSB

TAYLOR DEVICES, INC. AND SUBSIDIARY

Condensed Consolidated Balance Sheets	**(Unaudited) February 28, 2006**	May 31, 2005
Assets		
Current assets:		
Cash and cash equivalents	**$ 82,545**	$ 63,397
Accounts receivable, net	**1,120,320**	2,718,902
Inventory	**4,442,952**	4,771,086
Costs and estimated earnings in excess of billings	**4,372,314**	1,657,170

Other current assets	**1,023,469**	920,638
Total current assets	**11,041,600**	10,131,193
Maintenance and other inventory, net	**588,489**	661,500
Property and equipment, net	**3,360,215**	3,477,672
Investment in affiliate, at equity	**444,088**	451,877
Intangible and other assets	**166,314**	168,376
	$ 15,600,706	$ 14,890,618
Liabilities and Stockholders' Equity		
Current liabilities:		
Short-term borrowings and current portion of long-term debt	**$ 1,986,527**	$ 1,621,119
Payables - trade	**1,116,919**	770,330
Accrued commissions	**881,407**	576,550
Billings in excess of costs and estimated earnings	**54,000**	288,003
Other current liabilities	**455,377**	386,586
Total current liabilities	**4,494,230**	3,642,588
Long-term liabilities	**810,239**	998,719
Payables - affiliate	**298,551**	589,976
Minority stockholder's interest	**474,567**	450,991
Stockholders' Equity:		
Common stock and additional paid-in capital	**4,397,167**	4,391,001
Retained earnings	**6,018,921**	5,710,312
	10,416,088	10,101,313
Treasury stock - at cost	**(892,969)**	(892,969)
Total stockholders' equity	**9,523,119**	9,208,344
	$ 15,600,706	$ 14,890,618

See notes to condensed consolidated financial statements.

TAYLOR DEVICES, INC. AND SUBSIDIARY

Condensed Consolidated Statements of Income	**(Unaudited)**		**(Unaudited)**	
	For the three months ended February 28,		For the nine months ended February 28,	
	2006	2005	**2006**	2005
Sales, net	**$ 4,114,446**	$ 2,619,488	**$ 10,594,573**	$ 7,720,634
Cost of goods sold	**2,997,885**	1,937,083	**7,425,852**	5,387,173

Gross profit	**1,116,561**	682,405	**3,168,721**	2,333,461
Selling, general and administrative expenses	**950,870**	701,495	**2,547,335**	2,149,215
Operating income (loss)	**165,691**	(19,090)	**621,386**	184,246
Other expense, net	**(26,837)**	(35,719)	**(77,413)**	(104,781)
Income (loss) before provision for income taxes, equity in net income of affiliate and minority stockholder's interest	**138,854**	(54,809)	**543,973**	79,465
Provision for income taxes (benefit)	**50,000**	(16,700)	**204,000**	21,300
Income (loss) before equity in net income of affiliate and minority stockholder's interest	**88,854**	(38,109)	**339,973**	58,165
Equity in net income (loss) of affiliate	**(1,337)**	1,804	**(7,789)**	9,622
Income (loss) before minority stockholder's interest	**87,517**	(36,305)	**332,184**	67,787
Minority stockholder's interest	**(8,974)**	(6,240)	**(23,576)**	(23,245)
Net income (loss)	**$ 78,543**	$ (42,545)	**$ 308,608**	$ 44,542
Basic and diluted earnings (loss) per common share	**$ 0.03**	$ (0.01)	**$ 0.10**	$ 0.01

See notes to condensed consolidated financial statements.

TAYLOR DEVICES, INC. AND SUBSIDIARY

Condensed Consolidated Statements of Cash Flows

	(Unaudited)	
	February 28,	
For the nine months ended	**2006**	2005
Cash flows from operating activities:		
Net income	**$ 308,608**	$ 44,542
Adjustments to reconcile net income to net cash flows from operating activities:		
Depreciation and amortization	**242,603**	266,292
Gain on sale of equipment		
Bad debts expense	**9,157**	16,000

Equity in net income (loss) of affiliate	**7,789**	(9,622)
Deferred income taxes		
Minority stockholder's interest	**23,576**	23,245
Changes in other assets and liabilities:		
Accounts receivable	**1,589,425**	(146,684)
Inventory	**401,145**	(718,627)
Costs and estimated earnings in excess of billings	**(2,715,144)**	(792,504)
Other current assets	**(110,163)**	(112,406)
Payables - trade	**346,589**	(175,111)
Accrued commissions	**304,857**	(14,561)
Billings in excess of costs and estimated earnings	**(234,003)**	319,666
Other current liabilities	**68,791**	(168,026)
Net cash flows from (for) operating activities	**243,230**	(1,467,796)
Cash flows from investing activities:		
Acquisition of property and equipment	**(118,845)**	(130,198)
Other investing activities	**3,094**	(16,585)
Net cash flows for investing activities	**(115,751)**	(146,783)
Cash flows from financing activities:		
Net short-term borrowings and repayments on long-term debt	**176,928**	1,433,710
Payables - affiliate	**(291,425)**	(175,764)
Proceeds from long-term debt		
Proceeds from issuance of common stock	**6,166**	300,526
Net cash flows from (for) financing activities	**(108,331)**	1,558,472
Net increase (decrease) in cash and cash equivalents	**19,148**	(56,107)
Cash and cash equivalents - beginning	**63,397**	88,390
Cash and cash equivalents - ending	**$ 82,545**	$ 32,283

See notes to condensed consolidated financial statements.

TAYLOR DEVICES, INC.

Notes to Condensed Consolidated Financial Statements

1. The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-QSB and Regulation S-B. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of the Company, the accompanying unaudited condensed consolidated financial statements contain all adjustments (consisting of only normal recurring accruals) necessary to present fairly the financial position as of February 28, 2006 and May 31, 2005, the results of operations for the three and nine months ended February 28, 2006 and February 28, 2005, and cash flows for the nine months ended February 28, 2006 and February 28, 2005. These

financial statements should be read in conjunction with the audited financial statements and notes thereto contained in the Company's Annual Report to Shareholders for the year ended May 31, 2005. There have been no updates or changes to our audited financial statements for the year ended May 31, 2005.

2. There is no provision nor shall there be any provisions for profit sharing, dividends, or any other benefits of any nature at any time for this fiscal year.

3. For the three and nine month periods ended February 28, 2006 and 2005 the net income was divided by 3,102,603 and 3,033,761, respectively, which is net of the Treasury shares, to calculate the net income per share.

4. The results of operations for the nine month period ended February 28, 2006 are not necessarily indicative of the results to be expected for the full year.

5. Significant Equity Investee: The Company owns approximately a 23% equity investment in Tayco Developments, Inc. (Developments). For the nine months ended February 28, 2006, Developments had revenues of $177,000 and net income of $37,000. The carrying amount of the investment in Developments as of February 28, 2006 and May 31, 2005 was $444,000 and $452,000.

TAYLOR DEVICES, INC.

Item 2. Management's Discussion and Analysis or Plan of Operation

Cautionary Statement

The Private Securities Litigation Reform Act of 1995 provides a "safe harbor" for forward-looking statements. Information in this Item 2, "Management's Discussion and Analysis or Plan of Operation," and elsewhere in this 10-QSB that does not consist of historical facts, are "forward-looking statements." Statements accompanied or qualified by, or containing, words such as "may," "will," "should," "believes," "expects," "intends," "plans," "projects," "estimates," "predicts," "potential," "outlook," "forecast," "anticipates," "presume," and "assume" constitute forward-looking statements and, as such, are not a guarantee of future performance. The statements involve factors, risks and uncertainties, the impact or occurrence of which can cause actual results to differ materially from the expected results described in such statements. Risks and uncertainties can include, among others, fluctuations in general business cycles and changing economic conditions; changing product demand and industry capacity; increased competition and pricing pressures; advances in technology that can reduce the demand for the Company's products, as well as other factors, many or all of which may be beyond the Company's control. Consequently, investors should not place undue reliance on forward-looking statements as predictive of future results. The Company disclaims any obligation to release publicly any updates or revisions to the forward-looking statements herein to reflect any change in the Company's expectations with regard thereto, or any changes in events, conditions or circumstances on which any such statement is based.

Results of Operations

A summary of the period to period changes in the principal items included in the consolidated statements of income is shown below:

Summary comparison of the nine months ended February 28, 2006 and 2005

	Increase / (Decrease)
Sales, net	$ 2,874,000
Cost of goods sold	$ 2,039,000
Selling, general and administrative expenses	$ 398,000
Other expense, net	$ (27,000)

Income (loss) before provision for income taxes, equity in net income of affiliate and minority stockholder's interest	$ 465,000
Provision for income taxes (benefit)	$ 183,000
Income (loss) before equity in net income of affiliate and minority stockholder's interest	$ 282,000
Equity in net income (loss) of affiliate	$ (17,000)
Net income (loss)	$ 264,000

Sales under certain fixed-price contracts, requiring substantial performance over several periods prior to commencement of deliveries, are accounted for under the percentage-of-completion method of accounting whereby revenues are recognized based on estimates of completion prepared on a ratio of cost to total estimated cost basis. Costs include all material and direct and indirect charges related to specific contracts.

Adjustments to cost estimates are made periodically and any losses expected to be incurred on contracts in progress are charged to operations in the period such losses are determined. However, any profits expected on contracts in progress are recognized over the life of the contract.

For financial statement presentation purposes, the Company nets progress billings against the total costs incurred on uncompleted contracts. The asset, "costs and estimated earnings in excess of billings," represents revenues recognized in excess of amounts billed. The liability, "billings in excess of costs and estimated earnings," represents billings in excess of revenues recognized.

For the nine months ended February 28, 2006 (All figures being discussed are for the nine months ended February 28, 2006 as compared to the nine months ended February 28, 2005.)

	Nine months ended		**Change**	
	February 28, 2006	**February 28, 2005**	**Increase / (Decrease)**	**Percent Change**
Net Revenue	$10,595,000	$7,721,000	$ 2,874,000	*37%*
Cost of sales	7,426,000	5,387,000	2,039,000	*38%*
Gross profit	$ 3,169,000	$2,334,000	$ 835,000	*36%*
…as a percentage of net revenues	*30%*	*30%*		

The Company's consolidated results of operations showed a 37% increase in net revenues and an increase in net income of 593%. Gross profit increased by 36%. Revenues recorded in the current period for long-term construction projects increased by 84% over the unusually low level recorded in the prior year. The increase in revenue in the current year is attributable to 1.) a 52% increase in the quantity of long-term construction projects this year compared to last year, and 2.) a 42% increase in the average total sales value of long-term construction projects this year compared to last year. Management has noticed an increase in the global level of construction activity of structures requiring seismic protection. This has resulted in an increased number of inquiries and quotes for our products. Many of our bids to supply our products for these projects have been successful this year. These current year's projects contributed a gross profit margin of 33% as compared to 30% in the prior year's period. The overall gross profit as a percentage of net revenues for the current and prior year periods was 30%. Management is optimistic that the level of construction activity of structures requiring seismic protection will remain strong through the fiscal year. Based on this and our current sales order backlog of $13.2 million, management expects that the results achieved year-to-date will continue through the end of the current fiscal year.

The Company's revenues and net income fluctuate from period to period. The increases in the current period, compared to the prior period, are not necessarily representative of future results.

Selling, General and Administrative Expenses

	Nine months ended		**Change**	
	February 28, 2006	**February 28, 2005**	**Increase / (Decrease)**	**Percent Change**
Outside Commissions	$ 706,000	$ 305,000	$ 401,000	*131%*
Royalties	80,000	122,000	(42,000)	*-34%*
Other SG&A	1,761,000	1,722,000	39,000	*2%*
Total SG&A	$2,547,000	$2,149,000	$ 398,000	*19%*
…as a percentage of net revenues	*24%*	*28%*		

Selling, general and administrative expenses increased by 19% from the prior year. Commission expense increased by 131% over last year's level. Commission expense was higher in this period due to higher commission rates on a few large, long-term construction projects in production, in addition to a higher volume of sales subject to commission. Royalty expense is 34% less than the amount recorded in the prior year period. There were fewer shipments that were subject to royalty during the current year. Other selling, general and administrative expenses increased by only 2% from last year to this.

The above factors resulted in operating income of $621,000 for the nine months ended February 28, 2006, up 237% from the $184,000 in the same period of the prior year.

Other expense, net, of $77,000 is primarily interest expense and is 26% less than in the prior year. Interest expense decreased by $31,000 from the prior year. The average level of use of the Company's operating line of credit decreased significantly as compared to last year. The line of credit is used primarily to fund the production of larger projects that do not allow for advance payments or progress payments.

For the three months ended February 28, 2006 (All figures being discussed are for the three months ended February 28, 2006 as compared to the three months ended February 28, 2005.)

Summary comparison of the three months ended February 28, 2006 and 2005

	Increase / (Decrease)
Sales, net	$ 1,495,000
Cost of goods sold	$ 1,061,000
Selling, general and administrative expenses	$ 249,000
Other expense, net	$ (9,000)
Income (loss) before provision for income taxes, equity in net income of affiliate and minority stockholder's interest	$ 194,000
Provision for income taxes (benefit)	$ 67,000
Income (loss) before equity in net income of affiliate and minority stockholder's interest	$ 127,000
Equity in net income (loss) of affiliate	$ (3,000)
Net income (loss)	$ 121,000

	Three months ended		Change	
	February 28, 2006	**February 28, 2005**	**Increase / (Decrease)**	**Percent Change**
Net Revenue	$4,114,000	$2,619,000	$ 1,495,000	*57%*
Cost of sales	2,998,000	1,937,000	1,061,000	*55%*
Gross profit	$1,116,000	$ 682,000	$ 434,000	*64%*
…as a percentage of net revenues	*27%*	*26%*		

The Company's consolidated results of operations showed a 57% increase in net revenues with an increase in net income from a loss of $43,000 to income of $78,000. Gross profit increased by 64%. Revenues recorded in the current period for long-term construction projects increased by 106% over the level recorded in the prior year. The reasons for the increase are the same as stated above for the nine-month period. These current year's projects contributed a gross profit margin of 31% as compared to an unusually low 24% in the prior year's period. The overall gross profit as a percentage of net revenues for the quarter was 27% as compared to 26% for the same period in the prior year.

The Company's revenues and net income fluctuate from period to period. The increases in the current period, compared to the prior period, are not necessarily representative of future results.

Selling, General and Administrative Expenses

	Three months ended		Change	
	February 28, 2006	**February 28, 2005**	**Increase / (Decrease)**	**Percent Change**
Outside Commissions	$ 341,000	$ 124,000	$ 217,000	*175%*

Royalties	22,000	30,000	(8,000)	*-27%*
Other SG&A	588,000	547,000	41,000	*7%*
Total SG&A	$ 951,000	$ 701,000	$ 250,000	*36%*
…as a percentage of net revenues	*23%*	*27%*		

Selling, general and administrative expenses increased by 36% from the prior year. Commission expense increased by $217,000 over last year's level. Commission expense was higher in this period due to higher commission rates on a few large, long-term construction projects in production, in addition to a higher volume of sales subject to commission. Royalty expense is 27% less than the amount recorded in the prior year period. There were fewer shipments that were subject to royalty during the current year. Other selling, general and administrative expenses increased by only 7% from last year to this.

The above factors resulted in an operating income of $166,000 for the three months ended February 28, 2006 as compared to an operating loss of $19,000 in the same period of the prior year.

Other expense, net, of $26,000 is primarily interest expense and is 25% less than in the prior year. Interest expense decreased by $14,000 from the prior year for the same reasons noted above for the nine month period.

Capital Resources, Line of Credit and Long-Term Debt

The Company's primary liquidity is dependent upon the working capital needs. These are primarily inventory, accounts receivable, costs and estimated earnings in excess of billings, accounts payable, accrued commissions, billings in excess of costs and estimated earnings, and debt service. The Company's primary sources of liquidity have been operations and bank financing.

Capital expenditures for the nine months ended February 28, 2006 were $119,000 compared to $130,000 in the same period of the prior year. The Company has commitments to pay $154,000 for production machinery in the quarter ending May 31, 2006.

The Company has a $5,000,000 line of credit with a bank. There is a $1,739,000 principal balance outstanding as of February 28, 2006, which is up from the $1,390,000 balance outstanding as of May 31, 2005. The outstanding balance on the line of credit will fluctuate as the Company's various long-term projects progress. The Company is in compliance with restrictive covenants under the line of credit. Additional information regarding the covenants appears in Part II, item 2(d) of this Report.

Principal maturities of long-term debt for the remainder of the current fiscal year and the subsequent five years are as follows: 2006 - $52,000; 2007 - $241,000; 2008 - $232,000; 2009 - $138,000; 2010 - $72,000; and 2011 - $27,000.

Inventory and Maintenance Inventory

	February 28, 2006		**May 31, 2005**		**Increase**			
Raw Materials	$ 380,000		$ 404,000		$ (24,000)	*-6%*		
Work in process	3,688,000		4,029,000		(341,000)	*-8%*		
Finished goods	375,000		338,000		37,000	*11%*		
Inventory	4,443,000	*88%*	4,771,000	*88%*	(328,000)	*-7%*		
Maintenance and other inventory	588,000	*12%*	662,000	*12%*	(74,000)	*-11%*		
Total							278(M)	(6,335)

Income (loss) from continuing operations before income taxes	19,968	9,965	576	1,203	1,330	(743)	2,206	3,979		(15,768)	22,716
Income tax benefit	269										269
Net income (loss) from continuing operations	20,237	9,965	576	1,203	1,330	(743)	2,206	3,979		(15,768)	22,985
Preferred share dividends	(6,857)	(3,276)									(10,133)
	$ 13,380	$ 6,689	$ 576	$ 1,203	$ 1,330	$ (743)	$ 2,206	$ 3,979	$	$ (15,768)	$ 12,852

	Historical Consolidated	Other Pro Forma Adjustments	Total
Net income (loss) from continuing operations available to Common Shareholders			
Earnings per share: Basic	$ 0.67		$ 0.64
Earnings per share: Diluted	$ 0.64		$ 0.62
Weighted average number of shares: Basic	20,099		20,099
Diluted	21,623	79(N)	21,702

See accompanying notes and management's assumptions to pro forma financial statements.

Corporate Office Properties Trust
Pro Forma Condensed Consolidating Statement of Operations
For the Nine Month Period Ended September 30, 2002
(Unaudited)
(Dollars in thousands, except per share data)

	Historical Consolidated (A)	7320 Parkway Drive (C)	Rivers 95 (D)	7000 Columbia Gateway Drive (E)	8815 Centre Park Drive (F)	11800 Tech Road (G)	15049 and 15059 Conference Center Drive (H)	Cedar Knolls (I)	Other Pro Forma Adjustments	Total
Revenues										
Rental revenue	$ 98,037	$ 150	$ 324	$ 557	$ (645)	$ 1,696	$ 3,618	$	$	$ 103,737
Tenant recoveries and other revenue	11,970	14	53		(8)	491	872			13,392
Service operation revenue	3,194									3,194
Total revenues	113,201	164	377	557	(653)	2,187	4,490			120,323
Expenses										
Property operating	32,907	24	74		(260)	524	1,569			34,838
General and administrative	4,925									4,925
Interest and amortization of deferred financing costs	29,885								2,190 (J)	32,075
Depreciation and other amortization	20,486								1,128 (K)	21,614
Service operation expense	3,353									3,353
Total expenses	91,556	24	74		(260)	524	1,569		3,318	96,805

	Historical Consolidated (A)	7320 Parkway Drive (C)	Rivers 95 (D)	7000 Columbia Gateway Drive (E)	8815 Centre Park Drive (F)	11800 Tech Road (G)	15049 and 15059 Conference Center Drive (H)	Cedar Knolls (I)	Other Pro Forma Adjustments	Total
Gain (loss) on sale of properties	1,742				(19)					1,723
Equity in income of unconsolidated subsidiaries	114									114
Income (loss) before minority interests and income taxes	23,501	140	303	557	(412)	1,663	2,921		(3,318)	25,355
Minority interests										
Preferred Units	(1,716)									(1,716)
Other partnerships	59									59
Common Units	(4,407)								(581)(M)	(4,988)
Income (loss) from continuing operations before income taxes	17,437	140	303	557	(412)	1,663	2,921		(3,899)	18,710
Income tax benefit	43									43
Net income (loss) from continuing operations	17,480	140	303	557	(412)	1,663	2,921		(3,899)	18,753
Preferred share dividends	(7,600)									(7,600)
Net income (loss) from continuing operations available to Common Shareholders	$ 9,880	$ 140	$ 303	$ 557	$ (412)	$ 1,663	$ 2,921	$	$ (3,899)	$ 11,153
Earnings per share: Basic	$ 0.44									$ 0.50
Earnings per share: Diluted	$ 0.42									$ 0.48
Weighted average number of shares:										
Basic	22,215									22,215
Diluted	24,285									24,285

See accompanying notes and management's assumptions to pro forma financial statements.

F-6

CORPORATE OFFICE PROPERTIES TRUST
NOTES AND MANAGEMENT'S ASSUMPTIONS TO
PRO FORMA CONDENSED CONSOLIDATING
FINANCIAL INFORMATION
(Dollars in thousands, except share and per share amounts)

1. Basis of Presentation:

Corporate Office Properties Trust and subsidiaries (the "Company") is a self-administered Maryland real estate investment trust. As of September 30, 2002, the Company's portfolio included 111 office properties, including one owned through a joint venture.

These pro forma condensed consolidating financial statements should be read in conjunction with the historical financial statements and notes thereto of the Company, the Airport Square Properties, the Gateway 63 Properties, Washington Technology Park, 7000 Columbia Gateway Drive, 11800 Tech Road and 15049 and 15059 Conference Center Drive. In management's opinion, all adjustments necessary to reflect the effects of the 2001 Transactions, the 2002 Transactions and the probable Cedar Knolls acquisition have been made. This pro forma condensed consolidating financial information is unaudited and is not necessarily indicative of what the Company's actual financial position would have been at September 30, 2002 or what the results of operations would have been for the year ended December 31, 2001 or the nine months ended September 30, 2002, nor does it purport to represent the future financial position and results of operations of the Company.

2. Adjustments to Pro Forma Condensed Consolidating Balance Sheet:

(A) Reflects the historical consolidated balance sheet of the Company as of September 30, 2002.

(B)
Reflects the probable acquisition of Cedar Knolls from an affiliate of Constellation Real Estate, Inc. using $17,128 in seller financing and $2,560 in cash.

3. Adjustments to Pro Forma Condensed Consolidating Statements of Operations:

(A)
Reflects the historical consolidated operations of the Company for the period indicated.

F-7

(B)
The pro forma adjustments associated with the 2001 Transactions are set forth in the table below.

	State Farm Properties (i)	19 Commerce Drive (ii)	Airport Square Properties (iii)	Gateway 63 Properties (iv)	Washington Technology Park (v)	Preferred Share Issuances (vi)	Total
Revenues							
Rental income	$ 611	$ (779)	$ 3,266	$ 2,112	$ 5,400	$	$ 10,610
Tenant recoveries and other revenue	(50)	(4)	237	261	3,955		4,399
Total revenues	561	(783)	3,503	2,373	9,355		15,009
Expenses							
Property operating	322	(207)	949	337	4,095		5,496
General and administrative							
Interest						(2,048)	(2,048)
Depreciation and amortization							
Total expenses	322	(207)	949	337	4,095	(2,048)	3,448
Gain (loss) on sale of properties		(1,596)					(1,596)

	State Farm Properties (i)	19 Commerce Drive (ii)	Airport Square Properties (iii)	Gateway 63 Properties (iv)	Washington Technology Park (v)	Preferred Share Issuances (vi)	Total
Net income (loss) from continuing operations	239	(2,172)	2,554	2,036	5,260	2,048	9,965
Preferred share dividends						(3,276)	(3,276)
Income (loss) before minority interests and income taxes	$ 239	$ (2,172)	$ 2,554	$ 2,036	$ 5,260	$ (1,228)	$ 6,689

(i)
Reflects the effects of the historical operations of the State Farm Properties prior to their acquisition on May 14, 2001.

(ii)
Reflects the elimination of the historical operations of 19 Commerce Drive prior to its disposition on June 18, 2001.

(iii)
Reflects the effects of the historical operations of the Airport Square Properties prior to their acquisition in 2001.

(iv)
Reflects the effects of the historical operations of the Gateway 63 Properties prior to their acquisition on August 30, 2001.

(v)
Reflects the effects of the historical operations of the Washington Technology Park prior to its acquisition on November 30, 2001.

(vi)
Reflects the effects of the issuance of the 2001 Preferred Share Issuances as if such issuances and the resulting repayments of debt occurred on January 1, 2001.

F-8

The two tables that follow set forth detailed information pertaining to the pro forma adjustments for interest expense and preferred share dividends associated with the 2001 Preferred Shares Issuances.

	For the Year Ended December 31, 2001
Interest expense:	
Series D Preferred Share issuance $8,245 of proceeds used to pay down the Revolving Credit Facility, bearing interest on the outstanding balance at LIBOR plus 175 basis points.	$ (51)
Series E Preferred Share issuance $26,905 of the proceeds used to pay down the Revolving Credit Facility, bearing interest on the outstanding balance at LIBOR plus 175 basis points.	(538)
Series F Preferred Share issuance $31,200 of the proceeds used to pay down the Revolving Credit Facility, bearing interest on the outstanding balance at LIBOR plus 175 basis points.	(1,459)
Total	$ (2,048)

The pro forma adjustments above reflect an aggregate decrease to interest expense; this decrease to interest expense would decrease by a total of $37 for the year ended December 31, 2001 if interest rates on variable rate debt were 1/8th of a percentage point higher.

		For the Year Ended December 31, 2001
Preferred Share dividends:		
Series D Preferred Share issuance 544,000 shares issued with an aggregate liquidation preference of $13,600, paying dividends at a yearly rate of 4% of such liquidation preference.	$	36
Series E Preferred Share issuance 1,150,000 shares issued with an aggregate liquidation preference of $28,750, paying dividends at a yearly rate of 10.25% of such liquidation preference.		778
Series F Preferred Share issuance 1,425,000 shares issued with an aggregate liquidation preference of $35,625, paying dividends at a yearly rate of 9.875% of such liquidation preference.		2,462
Total	$	3,276

(C)
Reflects the effects of the historical operations of 7320 Parkway Drive prior to its acquisition on April 4, 2002.

(D)
Reflects the effects of the historical operations of Rivers 95 prior to its acquisition on April 4, 2002.

(E)
Reflects the effects of the historical operations of 7000 Columbia Gateway Drive prior to its acquisition on May 31, 2002.

(F)
Reflects the elimination of the historical operations of 8815 Centre Park Drive prior to its disposition on July 17, 2002.

F-9

(G)
Reflects the effects of the historical operations of 11800 Tech Road prior to its acquisition on August 1, 2002.

(H)
Reflects the effects of the historical operations of 15049 and 15059 Conference Center Drive prior to their acquisition on August 14, 2002.

(I)
Reflects the effects of the historical operations of Cedar Knolls for the periods presented. Cedar Knolls is a land parcel with no historical operating activity.

(J)
Pro forma adjustments for additional interest expense resulting from acquisition activity are set forth below. Pro forma adjustments are also set forth below for decreases in historical interest expense resulting from property dispositions. The pro forma adjustments below associated with the Revolving Credit Facility (carrying interest at a variable rate of LIBOR plus 175 basis points) and other variable rate loans were computed using the weighted average of the rates in effect for the applicable pro forma periods. Pro forma deferred financing cost amortization adjustments are reflected assuming such costs are amortized over the lives of the related loans.

Adjustment to interest expense, net of related historical amounts, as a result of:	For the Year Ended December 31, 2001	For the Nine Month Period Ended September 30, 2002
Borrowings under the Revolving Credit Facility of $12,915 in connection with the acquisition of the State Farm Properties.	$ 352	$
Debt repaid in connection with the sale of 19 Commerce Drive consisting of a $7,000 mortgage loan on the property with an interest rate of LIBOR plus 175 basis points.	(224)	
Borrowings in connection with the acquisition of the Airport Square Properties consisting of: (i) $16,215 under a mortgage loan bearing interest at LIBOR plus 175 basis points; (ii) $13,200 under the Revolving Credit Facility; and (iii) $7,862 under a mortgage loan bearing interest at 7.18% per annum.	1,347	
Borrowings in connection with the acquisition of the Gateway 63 Properties consisting of: (i) a 15,750 mortgage loan bearing interest at the Prime rate; and (ii) $4,295 under the Revolving Credit Facility.	1,020	
Borrowings in connection with the acquisition of the Washington Technology Park consisting of: (i) $32,078 under the Revolving Credit Facility; and (ii) $25,000 under a mortgage loan bearing interest at LIBOR plus 175 basis points.	3,198	
Borrowings under the Revolving Credit Facility of $4,957 in connection with the	290	46

Adjustment to interest expense, net of related historical amounts, as a result of:	**For the Year Ended December 31, 2001**	**For the Nine Month Period Ended September 30, 2002**
acquisition of 7320 Parkway Drive.		
Borrowings under the Revolving Credit Facility of $10,214 in connection with the acquisition of Rivers 95.	598	95
Borrowings under the Revolving Credit Facility of $15,800 in connection with the acquisition of 7000 Columbia Gateway Drive.	926	238

Debt repaid in connection with the sale of 8815 Centre Park Drive consisting of $3,500 under the Revolving Credit Facility.	(205)	(69)
Borrowings from debt in connection with the acquisition of 11800 Tech Road consisting of: (i) $22,000 under a mortgage loan bearing interest at LIBOR plus 160 basis points; and (ii) $5,184 under a mortgage loan bearing interest at 6.51% per annum.	1,593	647
Borrowings from debt in connection with the acquisition of 15049 and 15059 Conference Center Drive consisting of: (i) $30,916 under the Revolving Credit Facility; (ii) $16,000 under a mortgage loan bearing interest at 7.0% per annum; and (iii) $500 under a mortgage loan bearing interest at LIBOR plus 150 basis points.	2,961	1,407
Borrowing in connection with the probable acquisition of Cedar Knolls consisting of $17,128 in seller provided financing bearing interest at an imputed rated of 6%. No pro forma adjustment for interest expense is reflected since Management expects for land to be under development upon purchase.		
Amortization of deferred financing costs related to:		
19 Commerce Drive	(48)	
Airport Square Properties	82	(77)
Washington Technology Park	100	(82)
11800 Tech Road	98	(15)
	$ 12,088	$ 2,190

The pro forma adjustments above reflect an aggregate increase to interest expense. The aggregate pro forma increase to interest expense would increase by an additional $233 for the year ended December 31, 2001 and $69 for the nine months ended September 30, 2002 if interest rates on variable rate debt were 1/8th of a percentage point higher.

The pro forma adjustments resulting from acquisition activity were computed using the effects of initial debt incurred for such acquisitions; such adjustments do not reflect the effect of subsequent changes to the Company's debt, including activity to refinance initially incurred debt. If the pro forma adjustments reflected subsequent refinancings with debt secured by the properties acquired above, the aggregate pro forma increase to interest expense would increase by an additional $324 for the year ended December 31, 2001 and $75 for the nine months ended September 30, 2002. In addition, if the pro forma adjustments reflected the effects of other changes to the Company's debt, the aggregate increase to interest expense could be higher.

(K)
Pro forma depreciation expense adjustments are reflected on acquisitions based on a useful life of 40 years on the portion of the acquisition attributable to the building. Pro forma

depreciation and amortization expense adjustments on dispositions are reflected based on historical amounts.

Adjustment to depreciation and other amortization expense, net of related historical amounts, as a result of:	**For the Year Ended December 31, 2001**	**For the Nine Month Period Ended September 30, 2002**
Depreciation expense:		
State Farm Properties	$ 110	$
19 Commerce Drive	(109)	
Airport Square Properties	472	
Gateway 63 Properties	319	
Washington Technology Park	1,136	
7320 Parkway Drive	99	25
Rivers 95	231	58
7000 Columbia Gateway Drive	324	135
8815 Centre Park Drive	(197)	
11800 Tech Road	544	317
15049 and 15059 Conference Center Drive	949	593
Cedar Knolls		
Amortization of deferred leasing costs related to:		
19 Commerce Drive	(37)	
	$ 3,841	$ 1,128

(L)
Adjustment to reverse income recorded for our investment in certain of the Airport Square Properties under the equity method of accounting during 2001.

(M)
Adjustment for minority interests' share of pro forma adjustments made to the Operating Partnership.

(N)
Adjustment for additional weighted average Common Shares outstanding due to Series D Preferred Shares assumed issued at the beginning of 2001.

Report of Independent Accountants

To Corporate Office Properties Trust:

We have audited the accompanying historical summary of revenue and certain expenses of 7000 Columbia Gateway Drive (the "Property") as described in Note 1 for the year ended December 31, 2001. This historical summary is the responsibility of the Property management. Our responsibility is to express an opinion on this historical summary based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the historical summary is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the historical summary. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the historical summary. We believe that our audit provides a reasonable basis for our opinion.

The accompanying historical summary was prepared for the purpose of complying with the rules and regulations of the Securities and Exchange Commission (for inclusion on Form 8-K of Corporate Office Properties Trust) as described in Note 2, and is not intended to be a complete presentation of the Property's revenue and expenses.

In our opinion, the historical summary referred to above presents fairly, in all material respects, the revenue and certain expenses as described in Note 2 of the Property for the year ended December 31, 2001, in conformity with accounting principles generally accepted in the United States of America.

/s/ PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Baltimore, Maryland
November 15, 2002

F-13

7000 Columbia Gateway Drive
Historical Summary of Revenue and Certain Expenses
for the year ended December 31, 2001

Revenue		
Base rents	$	1,334,125
Total revenue		1,334,125
Certain expenses		
Miscellaneous expenses		4,351
Total property operating		4,351
Revenue in excess of certain expenses	$	1,329,774

The accompanying notes are an integral part of these historical summaries.

F-14

7000 Columbia Gateway Drive
Historical Summary of Revenue and Certain Expenses
for the three months ended March 31, 2002 (unaudited)

Revenue		

Base rents	$	333,531
Total revenue		333,531
Certain expenses		
Miscellaneous expenses		
Total property operating		
Revenue in excess of certain expenses	$	333,531

The accompanying notes are an integral part of these historical summaries.

7000 Columbia Gateway Drive
Notes to Historical Summaries

1. Business

The accompanying historical summary of revenue and certain expenses relates to the operations of 7000 Columbia Gateway Drive (the "Property"), consisting of the revenue and certain expenses of the building totaling 146,000 rentable square feet located in Howard County, Maryland.

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying historical summary of revenue and certain expenses was prepared for the purpose of complying with the rules and regulations of the Securities and Exchange Commission in contemplation of Corporate Office Properties Trust ("COPT") acquiring the Property. COPT acquired the Property in May 2002. The historical summary is not representative of the actual operations of the Property for the period presented nor indicative of future operations as certain expenses, primarily depreciation, amortization, allocable overhead and interest expense, which may not be comparable to the expenses expected to be incurred by Corporate Office Properties Trust in future operations of the Property, have been excluded.

Revenue and Expense Recognition

Revenue is recognized on a straight-line basis over the terms of the related lease. Expenses are recognized in the period in which they are incurred.

Use of Estimates

The preparation of this historical summary in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of revenue and expenses during the reporting period. Actual results may differ from these estimates.

Major Tenants

During 2001, the Property was leased to one tenant.

3. Rentals

The Property has entered into a non-cancelable tenant lease with a lease term through December 15, 2004. Such lease provides that the tenant will pay all operating expenses and real estate taxes associated with the space, as defined in the lease. Future minimum rentals as of December 31, 2001, to be received under this tenant lease are as follows:

2002	$	1,334,125
2003		1,334,125
2004		1,278,536
	$	3,946,786

4. Unaudited Historical Summary

The historical summary of revenue and certain expenses for the three months ended March 31, 2002 is unaudited. As a result, this interim historical summary should be read in conjunction with the historical summary of revenue and certain expenses and accompanying notes for the year ended December 31, 2001. The interim historical summary reflects all adjustments which management believes are necessary for the fair presentation of the historical summary of revenue and certain expenses for the interim period presented. These adjustments are of a normal recurring nature. The historical summary of revenue and certain expenses for such interim period is not necessarily indicative of the results for a full year.

Report of Independent Accountants

To Corporate Office Properties Trust:

We have audited the accompanying historical summary of revenue and certain expenses of 11800 Tech Road (the "Property") as described in Note 1 for the year ended December 31, 2001. This historical summary is the responsibility of the Property management. Our responsibility is to express an opinion on this historical summary based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the historical summary is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the historical summary. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the historical summary. We believe that our audit provides a reasonable basis for our opinion.

The accompanying historical summary was prepared for the purpose of complying with the rules and regulations of the Securities and Exchange Commission (for inclusion on Form 8-K of Corporate Office Properties Trust) as described in Note 2, and is not intended to be a complete presentation of the Property's revenue and expenses.

In our opinion, the historical summary referred to above presents fairly, in all material respects, the revenue and certain expenses as described in Note 2 of 11800 Tech Road for the year ended December 31, 2001, in conformity with accounting principles generally accepted in the United States of America.

/s/ PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Baltimore, Maryland
November 15, 2002

11800 Tech Road
Historical Summary of Revenue and Certain Expenses

for the year ended December 31, 2001

Revenue		
Base rents	$	2,389,669
Tenant reimbursements		501,681
Other income		98,897
Total revenue		2,990,247
Certain expenses		
Property operating expenses		
Property taxes		160,049
Management expenses		112,024
Other operating expenses		112,167
Other tenant reimbursable expenses		213,877
Total property operating		598,117
Repairs and maintenance		185,816
Total certain expenses		783,933
Revenue in excess of certain expenses	$	2,206,314

F-18

11800 Tech Road
Historical Summary of Revenue and Certain Expenses
for the six months ended June 30, 2002 (unaudited)

Revenue		
Base rents	$	1,454,001
Tenant reimbursements		384,846
Other income		36,384
Total revenue		1,875,231
Certain expenses		
Property operating expenses		
Property taxes		104,706
Management expenses		70,057
Other operating expenses		53,619
Other tenant reimbursable expenses		119,404
Total property operating		347,786
Repairs and maintenance		100,822
Total certain expenses		448,608
Revenue in excess of certain expenses	$	1,426,623

F-19

11800 Tech Road
Notes to Historical Summaries

1. Business

The accompanying historical summary of revenue and certain expenses relates to the operations of 11800 Tech Road (the "Property"), consisting of the revenue and certain expenses of the building totaling approximately 240,000 rentable square feet and a parking lot leasing approximately 100 spaces located in Silver Spring, Maryland.

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying historical summary of revenue and certain expenses was prepared for the purpose of complying with the rules and regulations of the Securities and Exchange Commission in contemplation of Corporate Office Properties Trust ("COPT") acquiring the Property. COPT acquired the Property in August 2002. The historical summary is not representative of the actual operations of the Property for the period presented nor indicative of future operations as certain expenses, primarily depreciation, amortization and interest expense, which may not be comparable to the expenses expected to be incurred by Corporate Office Properties Trust in future operations of the Property, have been excluded.

Revenue and Expense Recognition

Revenue is recognized on a straight-line basis over the terms of the related lease. Tenant reimbursements and other income are recognized when earned. Expenses are recognized in the period in which they are incurred.

Use of Estimates

The preparation of this historical summary in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of revenue and expenses during the reporting period. Actual results may differ from these estimates.

Major Tenants

During 2001, 98% of the Property's total base rents was earned from 4 major tenants, each of which amounted to over 10% of total base rents. Base rents earned from these 4 tenants for the year ended December 31, 2001 were approximately $1,222,000; $394,000; $315,000 and $290,000, respectively.

3. Rentals

The Property has entered into non-cancelable tenant leases, with expiration dates ranging from 2005 to 2009. Such leases provide that tenants will share in operating expenses and real estate taxes on a pro

F-20

rata basis, as defined in the leases. Future minimum rentals as of December 31, 2001, to be received under these tenant leases are as follows:

2002	$	2,796,316
2003		2,957,562
2004		3,112,992
2005		2,658,342
2006		1,940,942

Thereafter		1,160,054
	$	14,626,208

4. Management Fee Agreement and Tenant Service Contract

Certain management services for the year ended December 31, 2001 were performed by the owner of the Property at the rate of 4% of gross revenue generated by the operation of all phases of the Property.

5. Unaudited Interim Historical summary

The historical summary of revenue and certain expenses for the six months ended June 30, 2002 is unaudited. As a result, this interim historical summary should be read in conjunction with the historical summary of revenue and certain expenses and the accompanying notes for the year ended December 31, 2001. The interim historical summary reflects all adjustments which management believes are necessary for the fair presentation of the historical summary of revenue and certain expenses for the interim period presented. These adjustments are of a normal recurring nature. The historical summary of revenue and certain expenses for such interim period is not necessarily indicative of the results for a full year.

F-21

Report of Independent Accountants

To Corporate Office Properties Trust:

We have audited the accompanying historical summary of revenue and certain expenses of 15049 and 15059 Conference Center Drive (the "Properties") as described in Note 1 for the year ended December 31, 2001. This historical summary is the responsibility of the Property management. Our responsibility is to express an opinion on this historical summary based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the historical summary is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the historical summary. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the historical summary. We believe that our audit provides a reasonable basis for our opinion.

The accompanying historical summary was prepared for the purpose of complying with the rules and regulations of the Securities and Exchange Commission (for inclusion on Form 8-K of Corporate Office Properties Trust) as described in Note 2, and is not intended to be a complete presentation of the Properties' revenue and expenses.

In our opinion, the historical summary referred to above presents fairly, in all material respects, the revenue and certain expenses as described in Note 2 of the Properties for the year ended December 31, 2001, in conformity with accounting principles generally accepted in the United States of America.

/s/ PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Baltimore, Maryland
November 15, 2002

F-22

15049 and 15059 Conference Center Drive
Historical Summary of Revenue and Certain Expenses
for the year ended December 31, 2001

Revenue		
Base rents	$	5,216,130
Tenant reimbursements		1,307,920
Miscellaneous income		824
Total revenue		6,524,874
Certain expenses		
Property operating expenses		
Property taxes		655,302
Utilities		510,450
Management fee		179,644
Ground lease		228,880
Other operating expenses		202,295
Total property operating		1,776,571
Repairs and maintenance		769,763
Total certain expenses		2,546,334
Revenue in excess of certain expenses	$	3,978,540

The accompanying notes are an integral part of these historical summaries.

F-23

15049 and 15059 Conference Center Drive
Historical Summary of Revenue and Certain Expenses
for the six months ended June 30, 2002 (unaudited)

Revenue		
Base rents	$	2,925,867
Tenant reimbursements		705,141
Total revenue		3,631,008
Certain expenses		
Property operating expenses		
Property taxes		355,688
Utilities		261,299
Management fee		106,439
Ground lease		114,440
Other operating expenses		116,059
Total property operating		953,925
Repairs and maintenance		314,933
Total certain expenses		1,268,858

Revenue in excess of certain expenses	$	2,362,150

The accompanying notes are an integral part of these historical summaries.

15049 and 15059 Conference Center Drive
Notes to Historical Summaries

1. Business

The accompanying historical summary of revenue and certain expenses relates to the operations of 15049 and 15059 Conference Center Drive (the "Properties"), consisting of the revenue and certain expenses of two office buildings totaling 290,245 rentable square feet located in Chantilly, Virginia.

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying historical summary of revenue and certain expenses was prepared for the purpose of complying with the rules and regulations of the Securities and Exchange Commission in contemplation of Corporate Office Properties Trust acquiring the Property ("COPT"). COPT acquired the Properties in August 2002. The historical summary is not representative of the actual operations of the Property for the period presented nor indicative of future operations as certain expenses, primarily depreciation, amortization, and interest expense, which may not be comparable to the expenses expected to be incurred by Corporate Office Properties Trust in future operations of the Properties, have been excluded.

Revenue and Expense Recognition

Revenue is recognized on a straight-line basis over the terms of the related lease. Tenant reimbursements and other income are recognized when earned. Expenses are recognized in the period in which they are incurred.

Use of Estimates

The preparation of this historical summary in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of revenue and expenses during the reporting period. Actual results may differ from these estimates.

Major Tenants

During 2001, 74% of the Properties total base rents was earned from two major tenants, each of which amounted to over 20% of total base rents. Base rents earned from these two tenants for the year ended December 31, 2001 were approximately $2,380,000 and $1,476,000, respectively.

3. Rentals

The Properties have entered into non-cancelable tenant leases, with expiration dates ranging from 2005 to 2012. Such leases provide that tenants will share in operating expenses and real estate taxes on a pro

rata basis, as defined in the leases. Future minimum rentals as of December 31, 2001, to be received under these tenant leases are as follows:

2002	$	5,549,565
2003		5,878,583

2004	6,049,177
2005	6,181,953
2006	6,099,348
Thereafter	24,974,304
	$ 54,732,930

4. Management Fee Agreement

Certain management services for the twelve months ended December 31, 2001 were performed by the owner of the Property at the rate of 3% of gross rents. Per the management agreement gross rents include rental income, tenant reimbursement income, and other sums actually collected by the Manager on a monthly basis. During the year ended December 31, 2001 the Properties paid $179,644 in management fees.

5. Unaudited Interim Historical summary

The historical summary of revenue and certain expenses for the six months ended June 30, 2002 is unaudited. As a result, this interim historical summary should be read in conjunction with the historical summary of revenue and certain expenses and the accompanying notes for the year ended December 31, 2001. The interim historical summary reflects all adjustments which management believes are necessary for the fair presentation of the historical summary of revenue and certain expenses for the interim period presented. These adjustments are of a normal recurring nature. The historical summary of revenue and certain expenses for such interim period is not necessarily indicative of the results for a full year.

6. Ground Lease

15059 Conference Center Drive is subject to a ground lease contract that requires the payment of $228,880 annually. The ground lease commenced in January 1999 and has a term of 99 years.

F-26

QuickLinks

15049 and 15059 Conference Center Drive Historical Summary of Revenue and Certain Expenses for the six months ended June 30, 2002 (unaudited)

15049 and 15059 Conference Center Drive Notes to Historical Summaries