

RECKSON ASSOCIATES REALTY CORP

Form 10-Q

May 09, 2005

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2005

Commission file number: 1-13762

RECKSON ASSOCIATES REALTY CORP.

(Exact name of registrant as specified in its charter)

Maryland

11-3233650

(State or other jurisdiction of incorporation or
organization)

(IRS Employer Identification Number)

225 Broadhollow Road, Melville, NY

11747

(Address of principal executive office)

(zip code)

(631) 694-6900

(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) Yes No , and (2) has been subject to such filing requirements for the past 90 days.

Yes No .

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes No .

The company has one class of common stock, par value \$.01 per share, with 81,629,693 shares outstanding as of May 5, 2005

Reckson Associates Realty Corp.
Quarterly Report
For the Three months Ended March 31, 2005

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Part I **Financial Information**
Item 1 **Financial Statements**

Reckson Associates Realty Corp.
Consolidated Balance Sheets
(Dollars in thousands, except for share amounts)

	March 31, 2005	December 31, 2004
	(unaudited)	
Assets:		
Commercial real estate properties, at cost:		
Land	\$ 419,846	\$ 401,350
Building and improvements	2,755,580	2,681,742
Developments in progress:		
Land	98,176	88,606
Development costs	22,124	21,363
Furniture, fixtures and equipment	12,504	12,083
	<hr/>	<hr/>
	3,308,230	3,205,144
Less accumulated depreciation	(584,949)	(560,307)
	<hr/>	<hr/>
Investments in real estate, net of accumulated depreciation	2,723,281	2,644,837
Properties and related assets held for sale, net of accumulated depreciation	58,469	58,215
Investment in a real estate joint venture	6,808	6,657
Investment in notes receivable	113,254	85,855
Investments in affiliate loans and joint ventures	60,230	60,951
Cash and cash equivalents	25,537	25,137
Tenant receivables	10,427	9,532
Deferred rents receivable	139,348	132,251
Prepaid expenses and other assets	54,061	64,006
Contract and land deposits and pre-acquisition costs	256	121
Deferred leasing and loan costs.	81,074	80,046
	<hr/>	<hr/>
Total Assets	\$ 3,272,745	\$ 3,167,608
	<hr/>	<hr/>
Liabilities:		
Mortgage notes payable	\$ 606,723	\$ 609,518
Unsecured credit facility	357,500	235,500
Senior unsecured notes	698,039	697,974
Liabilities associated with properties held for sale	757	784
Accrued expenses and other liabilities.	65,473	73,565
Deferred revenues and tenant security deposits.	54,015	50,373
Dividends and distributions payable	36,137	35,924
	<hr/>	<hr/>
Total Liabilities	1,818,644	1,703,638
	<hr/>	<hr/>

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Minority partners' interests in consolidated partnerships	213,297	210,678
Preferred unit interest in the operating partnership	1,200	1,200
Limited partners' minority interest in the operating partnership	42,147	53,231
	<u> </u>	<u> </u>
Total Minority Interests	256,644	265,109
	<u> </u>	<u> </u>
Commitments and contingencies	□	□
Stockholders' Equity:		
Preferred stock, \$.01 par value, 25,000,000 shares authorized	□	□
Common Stock, \$.01 par value, 100,000,000 shares authorized 81,629,693 and 80,618,339 shares issued and outstanding, respectively	816	806
Additional paid in capital	1,265,133	1,266,547
Treasury stock, 3,318,600 shares	(68,492)	(68,492)
	<u> </u>	<u> </u>
Total Stockholders' Equity	1,197,457	1,198,861
	<u> </u>	<u> </u>
Total Liabilities and Stockholders' Equity	\$ 3,272,745	\$ 3,167,608
	<u> </u>	<u> </u>

(see accompanying notes to financial statements)

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Reckson Associates Realty Corp.
Consolidated Statements of Income
(Unaudited and in thousands, except per share and share amounts)

	<u>Three Months Ended March 31,</u>	
	<u>2005</u>	<u>2004</u>
Property operating revenues:		
Base Rents	\$ 117,382	\$ 109,408
Tenant escalations and reimbursements	18,502	17,978
	<hr/>	<hr/>
Total property operating revenues	135,884	127,386
	<hr/>	<hr/>
Operating Expenses:		
Property operating expenses	55,088	50,739
Marketing, general and administrative	8,205	7,046
Depreciation and amortization	29,728	27,729
	<hr/>	<hr/>
Total operating expenses	93,021	85,514
	<hr/>	<hr/>
Operating income	42,863	41,872
	<hr/>	<hr/>
Non-operating income and expenses:		
Interest income on notes receivable (including \$850, and \$590, respectively from related parties)	2,447	1,616
Investment income and other	747	4,046
Interest:		
Expense	(23,568)	(25,661)
Amortization of deferred financing costs	(1,038)	(927)
	<hr/>	<hr/>
Total non-operating income and expenses	(21,412)	(20,926)
	<hr/>	<hr/>
Income before minority interests, preferred dividends and distributions, equity in earnings of a real estate joint venture and discontinued operations	21,451	20,946
Minority partners' interests in consolidated partnerships	(3,779)	(6,181)
Limited partners' minority interest in the operating partnership	(772)	(573)
Distributions to preferred unit holders	□	(273)
Equity in earnings of a real estate joint venture	151	114
	<hr/>	<hr/>
Income before discontinued operations and dividends to preferred shareholders	17,051	14,033
Discontinued operations (net of minority interests):		
Income from discontinued operations	305	989
Gain on sales of real estate	□	5,202
	<hr/>	<hr/>
Net Income	17,356	20,224
Dividends to preferred shareholders	□	(4,260)
	<hr/>	<hr/>
Net income allocable to common shareholders	\$ 17,356	\$ 15,964
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Basic net income per weighted average common share:		
Common	\$.21	\$.16
Discontinued operations	□	.10

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Basic net income per common share	<u>\$.21</u>	<u>\$.26</u>
Basic weighted average common shares outstanding	81,100,109	61,363,097
Diluted net income per weighted average common share	\$.21	\$.26
Diluted weighted average common shares outstanding (see accompanying notes to financial statements)	81,520,971	61,718,028

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Reckson Associates Realty Corp.
Consolidated Statements of Cash Flows
(Unaudited and in thousands)

	Three Months Ended	
	March 31,	
	2005	2004
	<hr/>	<hr/>
Cash Flows From Operating Activities:		
Net Income	\$ 17,356	\$ 20,224
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization (including discontinued operations)	31,293	29,235
Minority partners' interests in consolidated partnerships	3,779	6,181
Limited partners' minority interest in consolidated partnerships	786	936
Gain on sales of real estate	□	(5,506)
Equity in earnings of a real estate joint venture	(151)	(114)
Changes in operating assets and liabilities:		
Deferred rents receivable	(7,097)	(3,817)
Prepaid expenses and other assets	11,083	7,237
Tenant receivables	(895)	3,132
Accrued expenses and other liabilities	(5,833)	(14,656)
	<hr/>	<hr/>
Net cash provided by operating activities	50,321	42,852
	<hr/>	<hr/>
Cash Flows From Investment Activities:		
Purchases of commercial real estate properties	(73,838)	(72,691)
Additions to developments in progress	(10,809)	(4,781)
Increase in contract and land deposits and pre-acquisition costs	(135)	□
Repayments of notes receivable	1,695	□
Additions to notes receivable	(28,390)	□
Additions to commercial real estate properties	(17,443)	(7,627)
Payment of deferred leasing costs	(4,373)	(4,584)
Distributions from investments in a real estate joint venture	□	68
Additions to furniture, fixtures and equipment	(421)	(68)
Proceeds from sales of real estate	□	18,450
	<hr/>	<hr/>
Net cash (used in) investing activities	(133,714)	(71,233)
	<hr/>	<hr/>
Cash Flows From Financing Activities:		
Principal payments on secured borrowings	(2,796)	(2,909)
Proceeds from issuance of senior unsecured notes, net of issuance costs	□	149,490
Repayment of senior unsecured notes	□	(100,000)
Payment of loan and equity issuance costs	(95)	(2,125)
Proceeds from unsecured credit facility	132,000	90,000
Principal payments on unsecured credit facility	(10,000)	(169,000)
Proceeds from issuance of common stock, net of issuance costs, and exercise of stock options	2,570	162,778

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Distributions to minority partners in consolidated partnerships	(1,313)	(5,093)
Distributions to limited partners in the operating partnership	(1,674)	(731)
Distributions to preferred unit holders	□	(273)
Dividends to common shareholders	(34,899)	(24,277)
Dividends to preferred shareholders	□	(4,998)
	<u>83,793</u>	<u>92,862</u>
Net cash provided by financing activities		
	<u>83,793</u>	<u>92,862</u>
Net increase in cash and cash equivalents	400	64,481
Cash and cash equivalents at beginning of period	25,137	22,887
	<u>25,137</u>	<u>22,887</u>
Cash and cash equivalents at end of period	\$ 25,537	\$ 87,368
	<u>\$ 25,537</u>	<u>\$ 87,368</u>

(see accompanying notes to financial statements)

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Reckson Associates Realty Corp.
Notes to the Consolidated Financial Statements
March 31, 2005
(Unaudited)

1. Organization and Formation of the Company

Reckson Associates Realty Corp. (the "Company") is a self-administered and self managed real estate investment trust ("REIT") engaged in the ownership, management, operation, acquisition, leasing, financing and development of commercial real estate properties, principally office and to a lesser extent industrial / R&D properties and also owns land for future development (collectively, the "Properties") located in the New York City tri-state area (the "Tri-State Area").

The Company was incorporated in Maryland in September 1994. In June 1995, the Company completed an Initial Public Offering (the "IPO") and commenced operations.

The Company became the sole general partner of Reckson Operating Partnership, L.P. (the "Operating Partnership") by contributing substantially all of the net proceeds of the IPO, in exchange for an approximate 73% interest in the Operating Partnership. All Properties acquired by the Company are held by or through the Operating Partnership. In conjunction with the IPO, the Operating Partnership executed various option and purchase agreements whereby it issued common units of limited partnership interest in the Operating Partnership ("OP Units") to certain continuing investors and assumed certain indebtedness in exchange for (i) interests in certain property partnerships, (ii) fee simple and leasehold interests in properties and development land, (iii) certain other business assets and (iv) 100% of the non-voting preferred stock of the management and construction companies. The Company's ownership percentage in the Operating Partnership was approximately 95.9% and 94.6% at March 31, 2005 and 2004, respectively.

2. Basis of Presentation

The accompanying interim unaudited financial statements have been prepared by the Company's management pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosure normally included in the financial statements prepared in accordance with U.S. generally accepted accounting principles ("GAAP") may have been condensed or omitted pursuant to such rules and regulations, although management believes that the disclosures are adequate to not make the information presented misleading. The unaudited financial statements at March 31, 2005 and for the three month periods ended March 31, 2005 and 2004 include, in the opinion of management, all adjustments, consisting of normal recurring adjustments, necessary to present fairly the financial information set forth herein. The results of operations for the interim periods are not necessarily indicative of the results that may be expected for the year ending December 31, 2005. These financial statements should be read in conjunction with the Company's audited financial statements and the notes thereto included in the Company's Form 10-K for the year ended December 31, 2004.

The accompanying consolidated financial statements include the consolidated financial position of the Company, the Operating Partnership and the Service Companies (as defined below) at March 31, 2005 and December 31, 2004 and the consolidated results of their operations and their cash flows for each of the three month periods ended March 31, 2005 and 2004. The Operating Partnership's investments in majority owned and controlled real estate joint ventures are reflected in the accompanying financial statements on a consolidated basis with a reduction for the minority partners' interest. The Operating Partnership also has an investment in a real estate joint venture where it owns less than a controlling interest. Such investment is reflected in the accompanying financial statements on the equity method of accounting. The Service Companies which provide management, development and construction services to the Company, the Operating Partnership and to third parties are Reckson Management Group, Inc., RANY Management Group, Inc., Reckson Construction & Development LLC and Reckson Construction Group New York, Inc. (collectively, the "Service Companies"). All significant intercompany balances and transactions have been eliminated in the consolidated financial statements.

Minority partners' interests in consolidated partnerships represent a 49% non-affiliated interest in RT Tri-State LLC, owner of a six property suburban office portfolio, a 40% non-affiliated interest in Omni Partners, L.P., owner of a 579,000 square foot suburban office property and a 49% non-affiliated interest in Metropolitan 919 3rd Avenue, LLC, owner of the property located at 919 Third Avenue, New York, NY. Limited partners' minority interests in the Operating Partnership was approximately 4.1% and 5.4% at March 31, 2005 and 2004, respectively.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and footnotes thereto. Actual results could differ from those estimates.

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Real Estate

Land, buildings and improvements, furniture, fixtures and equipment are recorded at cost. Tenant improvements, which are included in buildings and improvements, are also stated at cost. Expenditures for ordinary maintenance and repairs are expensed to operations as they are incurred. Renovations and / or replacements, which improve or extend the life of the asset, are capitalized and depreciated over their estimated useful lives.

Depreciation is computed utilizing the straight-line method over the estimated useful lives of ten to thirty years for buildings and improvements and five to ten years for furniture, fixtures and equipment. Tenant improvements, which are included in buildings and improvements, are amortized on a straight-line basis over the term of the related leases. Depreciation expense, net of discontinued operations, for each of the three month periods ended March 31, 2005 and 2004 amounted to approximately \$20.6 million and \$19.6 million, respectively.

We are required to make subjective assessments as to the useful lives of our properties for purposes of determining the amount of depreciation to reflect on an annual basis with respect to those properties. These assessments have a direct impact on our net income. Should we lengthen the expected useful life of a particular asset, it would be depreciated over more years, and result in less depreciation expense and higher annual net income.

On July 1, 2001 and January 1, 2002, we adopted Financial Accounting Standards Board (FASB) Statement No.141, Business Combinations and FASB Statement No. 142, Goodwill and Other Intangibles, respectively. As part of the acquisition of real estate assets, the fair value of the real estate acquired is allocated to the acquired tangible assets, consisting of land, building and building improvements, and identified intangible assets and liabilities, consisting of the value of above-market and below-market leases, other value of in-place leases, and value of tenant relationships, based in each case on their fair values.

We allocate a portion of the purchase price to tangible assets including the fair value of the building and building improvements on an as-if-vacant basis and to land determined either by real estate tax assessments, independent appraisals or other relevant data. Additionally, we assess fair value of identified intangible assets and liabilities based on estimated cash flow projections that utilize appropriate discount and capitalization rates and available market information.

Estimates of future cash flows are based on a number of factors including the historical operating results, known trends, and market/economic conditions that may affect the property. If we incorrectly estimate the values at acquisition or the undiscounted cash flows, initial allocation of purchase price and future impairment charges may be different.

Long Lived Assets

We are required to make subjective assessments as to whether there are impairments in the value of our real estate properties and other investments. An investment's value is impaired only if management's estimate of the aggregate future cash flows (undiscounted and without interest charges) to be generated by the investment are less than the carrying value of the investment. Such assessments consider factors such as cash flows, expected future operating income, trends and prospects, as well as the effects of demand, competition and other factors. To the extent impairment has occurred it will be measured as the excess of the carrying amount of the property over the fair value of the property. These assessments have a direct impact on our net income, because recognizing an impairment results in an immediate negative adjustment to net income. In determining impairment, if any, we have followed FASB Statement No. 144, Accounting for the Impairment or Disposal of Long Lived Assets. Statement No. 144 did not have an impact on net income allocable to common shareholders. Statement No. 144 only impacts the presentation of the results of operations and gain on sales of real estate assets for those properties sold during the period within the consolidated statements of income.

Cash Equivalents

We consider highly liquid investments with a maturity of three months or less when purchased to be cash equivalents.

Tenant's lease security deposits aggregating approximately \$4.5 million at March 31, 2005 and December 31, 2004 have been included in cash and cash equivalents on the accompanying balance sheets.

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Deferred Costs

Tenant leasing commissions and related costs incurred in connection with leasing tenant space are capitalized and amortized over the life of the related lease. In addition, loan costs incurred in obtaining financing are capitalized and amortized over the term of the related loan.

Costs incurred in connection with equity offerings are charged to stockholders' equity when incurred.

Income Taxes

Commencing with its taxable year ended December 31, 1995, the Company elected to be taxed as a REIT under the Internal Revenue Code of 1986, as amended (the "Code"). To qualify as a REIT, the Company must meet a number of organizational and operational requirements, including a requirement that it currently distribute at least 90% of its adjusted taxable income to its stockholders. It is management's current intention to adhere to these requirements and maintain the Company's REIT status. As a REIT, the Company generally will not be subject to corporate level federal income tax on taxable income it distributes currently to its stockholders. If the Company fails to qualify as a REIT in any taxable year, it will be subject to federal income taxes at regular corporate rates (including any applicable alternative minimum tax) and may not be able to qualify as a REIT for the subsequent four taxable years. Even if the Company qualifies for taxation as a REIT, the Company may be subject to certain state and local taxes on its income and property, and to federal income and excise taxes on its undistributed taxable income. In addition, taxable income from non-REIT activities managed through the Service Companies as taxable REIT subsidiaries are subject to federal, state and local income taxes.

Revenue Recognition & Accounts Receivable

Minimum rental revenue is recognized on a straight-line basis, which averages minimum rents over the terms of the leases. The excess of rents recognized over amounts contractually due are included in deferred rents receivable on the accompanying balance sheets. Contractually due but unpaid rents are included in tenant receivables on the accompanying balance sheets. Certain lease agreements also provide for reimbursement of real estate taxes, insurance, common area maintenance costs and indexed rental increases, which are recorded on an accrual basis. Ancillary and other property related income is recognized in the period earned.

We make estimates of the collectibility of our accounts receivables related to base rents, tenant escalations and reimbursements and other revenue or income. We specifically analyze tenant receivables and historical bad debts, customer credit worthiness, current economic trends and changes in customer payment terms when evaluating the adequacy of our allowance for doubtful accounts. In addition, when tenants are in bankruptcy, we make estimates of the expected recovery of pre-petition administrative and damage claims. In some cases, the ultimate resolution of those claims can exceed a year. These estimates have a direct impact on our net income because a higher bad debt reserve results in less net income.

We incurred approximately \$415,000 and \$657,000 of bad debt expense, net of discontinued operations, for the three month periods ended March 31, 2005 and 2004, respectively, related to tenant receivables which accordingly reduced our total revenues and reported net income during those periods.

We record interest income on our investments in notes receivable on the accrual basis of accounting. We do not accrue interest on impaired loans where, in the judgment of management, collection of interest according to the contractual terms is considered doubtful. Among the factors we consider in making an evaluation of the collectibility of interest are: (i) the status of the loan, (ii) the value of the underlying collateral, (iii) the financial condition of the borrower and (iv) anticipated future events.

Reckson Construction & Development LLC (the successor to Reckson Construction Group, Inc.) and Reckson Construction Group New York, Inc. use the percentage-of-completion method for recording amounts earned on their contracts. This method records amounts earned as revenue in the proportion that actual costs incurred to date bear to the estimate of total costs at contract completion.

Gain on sales of real estate are recorded when title is conveyed to the buyer, subject to the buyer's financial commitment being sufficient to provide economic substance to the sale and us having no substantial continuing

involvement with the buyer.

We follow the guidance provided for under FASB Statement No. 66 "Accounting for Sales of Real Estate" ("Statement No. 66"), which provides guidance on sales contracts that are accompanied by agreements which require the seller to develop the property in the future. Under Statement No. 66, profit is recognized and allocated to the sale of the land and the later development or construction work on the basis of estimated costs of each activity; the same rate of profit is attributed to each activity. As a result, profits are recognized and reflected over the improvement period on the basis of costs incurred (including land) as a percentage of total costs estimated to be incurred. We use the percentage of completion method, as future costs of development and profit are reliably estimated.

[Back to Contents](#)*Earnings Per Share*

In 1997, the FASB issued Statement No. 128, "Earnings per Share" ("Statement No. 128") which replaced the calculation of primary and fully diluted earnings per share with basic and diluted earnings per share. Unlike primary earnings per share, basic earnings per share excludes any dilutive effects of options, warrants and convertible securities. Diluted earnings per share are very similar to the previously reported fully diluted earnings per share. The conversion of OP Units into common stock would not have a significant effect on per share amounts as the OP Units share proportionately with the common stock in the results of the Operating Partnership's operations.

Stock Options

In December 2002, the FASB issued Statement No. 148, "Accounting for Stock-Based Compensation" Transition and Disclosure" ("Statement No. 148"). Statement No. 148 amends Statement No. 123 to provide alternative methods of transition for an entity that voluntarily adopts the fair value recognition method of recording stock option expense. Statement No. 148 also amends the disclosure provisions of Statement 123 and Accounting Principles Board Opinion No. 28, "Interim Financial Reporting" to require disclosure in the summary of significant accounting policies of the effects of an entity's accounting policy with respect to stock options on reported net income and earnings per share in annual and interim financial statements.

The following table sets forth our pro forma information for common shareholders (in thousands except earnings per share data):

	Three Months Ended March 31,	
	2005	2004
Net income allocable to common shareholders as reported	\$ 17,356	\$ 15,964
Add: Stock option expense included above	1	1
Deduct: Stock option expense determined under fair value recognition method for all awards	□	92