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CRESCENT REAL ESTATE EQUITIES CO

Form 10-Q

November 09, 2004

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

FOR QUARTER ENDED September 30, 2004
COMMISSION FILE NO. 1-13038

CRESCENT REAL ESTATE EQUITIES COMPANY

(Exact name of registrant as specified in its charter)

TEXAS

52-1862813

(State or other jurisdiction of
incorporation or organization)

(I.R.S. Employer Identification Number)

777 Main Street, Suite 2100, Fort Worth, Texas 76102

(Address of principal executive offices) (Zip code)

Registrant's telephone number, including area code (817) 321-2100

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 twelve (12) months (or for such shorter period that the registrant was required to file such report) and (2) has been subject to such filing requirements for the past ninety (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

Number of shares outstanding of each of the registrant's classes of preferred and common shares, as of October 31, 2004.

Series A Convertible Cumulative Preferred Shares, par value \$0.01 per share:
Series B Cumulative Redeemable Preferred Shares, par value \$0.01 per share:
Common Shares, par value \$0.01 per share:

14,200,
3,400,
97,532,

CRESCENT REAL ESTATE EQUITIES COMPANY
FORM 10-Q
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CRESCENT REAL ESTATE EQUITIES COMPANY
 CONSOLIDATED BALANCE SHEETS
 (in thousands, except share data)
 (unaudited)

	SEPTEMBER 2004

ASSETS:	
Investments in real estate:	
Land	\$ 274
Land improvements, net of accumulated depreciation of \$22,937 and \$19,270 at September 30, 2004 and December 31, 2003, respectively	113
Building and improvements, net of accumulated depreciation of \$650,194 and \$584,861 at September 30, 2004 and December 31, 2003, respectively	2,377
Furniture, fixtures and equipment, net of accumulated depreciation of \$38,374 and \$33,344 at September 30, 2004 and December 31, 2003, respectively	41
Land held for investment or development	505
Properties held for disposition, net	78

Net investment in real estate	\$ 3,389

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Cash and cash equivalents	\$ 64
Restricted cash and cash equivalents	75
Defeasance investments	170
Accounts receivable, net	48
Deferred rent receivable	79
Investments in unconsolidated companies	356
Notes receivable, net	74
Income tax asset-current and deferred, net	31
Other assets, net	295

Total assets	\$ 4,586
	=====
 LIABILITIES:	
Borrowings under Credit Facility	\$ 307
Notes payable	2,548
Accounts payable, accrued expenses and other liabilities	466
Current income tax payable	

Total liabilities	\$ 3,322

 COMMITMENTS AND CONTINGENCIES:	
MINORITY INTERESTS:	
Operating partnership, 8,863,889 and 8,873,347 units, at September 30, 2004 and December 31, 2003, respectively	\$ 83
Consolidated real estate partnerships	44

Total minority interests	\$ 127

 SHAREHOLDERS' EQUITY:	
Preferred shares, \$0.01 par value, authorized 100,000,000 shares:	
Series A Convertible Cumulative Preferred Shares, liquidation preference of \$25.00 per share, 14,200,000 and 10,800,000 shares issued and outstanding at September 30, 2004 and December 31, 2003, respectively	\$ 319
Series B Cumulative Preferred Shares, liquidation preference of \$25.00 per share, 3,400,000 shares issued and outstanding at September 30, 2004 and December 31, 2003	81
Common shares, \$0.01 par value, authorized 250,000,000 shares, 124,446,656 and 124,396,168 shares issued and outstanding at September 30, 2004 and December 31, 2003, respectively	1
Additional paid-in capital	2,245
Deferred compensation on restricted shares	(3)
Accumulated deficit	(1,043)
Accumulated other comprehensive income	(4)

	\$ 1,597
Less - shares held in treasury, at cost, 25,121,861 common shares at September 30, 2004 and December 31, 2003	(460)

Total shareholders' equity	\$ 1,137

Total liabilities and shareholders' equity	\$ 4,586
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The accompanying notes are an integral part of these consolidated financial statements.

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CRESCENT REAL ESTATE EQUITIES COMPANY
CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except share data)
(unaudited)

	FOR THE THREE ENDED SEPTEMBER	
	2004	2003
	-----	-----
REVENUE:		
Office Property	\$ 128,331	\$
Resort/Hotel Property	46,986	
Residential Development Property	60,595	
	-----	-----
Total Property revenue	\$ 235,912	\$
	-----	-----
EXPENSE:		
Office Property real estate taxes	\$ 15,719	\$
Office Property operating expenses	46,699	
Resort/Hotel Property expense	39,479	
Residential Development Property expense	54,480	
	-----	-----
Total Property expense	\$ 156,377	\$
	-----	-----
Income from Property Operations	\$ 79,535	\$
	-----	-----
OTHER INCOME (EXPENSE):		
Income from investment land sales, net	\$ 7,583	\$
Gain on joint venture of properties, net	-	
Interest and other income	2,576	
Corporate general and administrative	(9,023)	
Interest expense	(46,571)	
Amortization of deferred financing costs	(3,453)	
Extinguishment of debt	(155)	
Depreciation and amortization	(45,715)	
Impairment charges related to real estate assets	(4,094)	
Other expenses	(88)	
Equity in net income (loss) of unconsolidated companies:		
Office Properties	1,268	
Resort/Hotel Properties	22	
Residential Development Properties	(803)	
Temperature-Controlled Logistics Properties	(906)	
Other	190	
	-----	-----
Total Other Income (Expense)	\$ (99,169)	\$
	-----	-----
(LOSS) INCOME FROM CONTINUING OPERATIONS BEFORE MINORITY INTERESTS AND INCOME TAXES	\$ (19,634)	\$
Minority interests	710	
Income tax benefit	6,613	
	-----	-----

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(LOSS) INCOME BEFORE DISCONTINUED OPERATIONS AND CUMULATIVE			
EFFECT OF A CHANGE IN ACCOUNTING PRINCIPLE		\$ (12,311)	\$
Income from discontinued operations, net of minority interests		1,967	
Impairment charges related to real estate assets from discontinued operations, net of minority interests		(297)	
Loss on real estate from discontinued operations, net of minority interests		(32)	
Cumulative effect of a change in accounting principle, net of minority interests		-	
		-----	-----
NET (LOSS) INCOME		\$ (10,673)	\$
Series A Preferred Share distributions		(5,991)	
Series B Preferred Share distributions		(2,019)	
		-----	-----
NET LOSS AVAILABLE TO COMMON SHAREHOLDERS		\$ (18,683)	\$
		=====	=====
BASIC EARNINGS PER SHARE DATA:			
Loss available to common shareholders before discontinued operations and cumulative effect of a change in accounting principle		\$ (0.21)	\$
Income from discontinued operations, net of minority interests		0.02	
Impairment charges related to real estate assets from discontinued operations, net of minority interests		-	
Loss on real estate from discontinued operations, net of minority interests		-	
Cumulative effect of a change in accounting principle, net of minority interests		-	
		-----	-----
Net loss available to common shareholders - basic		\$ (0.19)	\$
		=====	=====
DILUTED EARNINGS PER SHARE DATA:			
Loss available to common shareholders before discontinued operations and cumulative effect of a change in accounting principle		\$ (0.21)	\$
Income from discontinued operations, net of minority interests		0.02	
Impairment charges related to real estate assets from discontinued operations, net of minority interests		-	
Loss on real estate from discontinued operations, net of minority interests		-	
Cumulative effect of a change in accounting principle, net of minority interests		-	
		-----	-----
Net loss available to common shareholders - diluted		\$ (0.19)	\$
		=====	=====

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

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	Preferred Shares		Preferred Shares		T
	Shares	Net Value	Shares	Net Value	
SHAREHOLDERS' EQUITY, December 31, 2003	10,800,000	\$ 248,160	3,400,000	\$ 81,923	25,1
Issuance of Common Shares	-	-	-	-	
Exercise of Common Share Options	-	-	-	-	
Accretion of Discount on Employee Stock Option Notes	-	-	-	-	
Issuance of Shares in Exchange for Operating Partnership Units	-	-	-	-	
Preferred Equity Issuance	3,400,000	71,006	-	-	
Stock Option Grants	-	-	-	-	
Amortization of Deferred Compensation on Restricted Shares	-	-	-	-	
Dividends Paid	-	-	-	-	
Net Loss Available to Common Shareholders	-	-	-	-	
Unrealized Gain on Marketable Securities	-	-	-	-	
Unrealized Net Gain on Cash Flow Hedges	-	-	-	-	
SHAREHOLDERS' EQUITY, September 30, 2004	14,200,000	\$ 319,166	3,400,000	\$ 81,923	25,1

	Common Shares		Additional Paid-in Capital	Deferred Compensation on Restricted Shares
	Shares	Par Value		
SHAREHOLDERS' EQUITY, December 31, 2003	124,396,168	\$ 1,237	\$ 2,245,683	\$ (4,10
Issuance of Common Shares	5,672	-	94	
Exercise of Common Share Options	25,900	1	361	
Accretion of Discount on Employee Stock Option Notes	-	-	(189)	
Issuance of Shares in Exchange for Operating Partnership Units	18,916	-	-	
Preferred Equity Issuance	-	-	-	
Stock Option Grants	-	-	(22)	
Amortization of Deferred Compensation				

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on Restricted Shares	-	-	-	97
Dividends Paid	-	-	-	
Net Loss Available to Common Shareholders	-	-	-	
Unrealized Gain on Marketable Securities	-	-	-	
Unrealized Net Gain on Cash Flow Hedges	-	-	-	
SHAREHOLDERS' EQUITY, September 30, 2004	<u>124,446,656</u>	<u>\$ 1,238</u>	<u>\$ 2,245,927</u>	<u>\$ (3,12)</u>

	Accumulated Other Comprehensive Income	Total
	-----	-----
SHAREHOLDERS' EQUITY, December 31, 2003	\$ (13,829)	\$ 1,221,804
Issuance of Common Shares	-	94
Exercise of Common Share Options	-	362
Accretion of Discount on Employee Stock Option Notes	-	(189)
Issuance of Shares in Exchange for Operating Partnership Units	-	-
Preferred Equity Issuance	-	71,006
Stock Option Grants	-	(22)
Amortization of Deferred Compensation on Restricted Shares	-	978
Dividends Paid	-	(111,781)
Net Loss Available to Common Shareholders	-	(54,772)
Unrealized Gain on Marketable Securities	1,445	1,445
Unrealized Net Gain on Cash Flow Hedges	8,198	8,198
SHAREHOLDERS' EQUITY, September 30, 2004	<u>\$ (4,186)</u>	<u>\$1,137,123</u>

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

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CONSOLIDATED STATEMENTS OF CASH FLOWS (dollars in thousands) (unaudited)

FOR THE NINE MONTHS
2004

CASH FLOWS FROM OPERATING ACTIVITIES:

Net loss	\$	(30,9
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization		137,9
Residential Development cost of sales		67,5
Residential Development capital expenditures		(126,6
Impairment charges related to real estate assets from discontinued operations, net of minority interests		2,7
Loss on real estate from discontinued operations, net of minority interests		2,1
Discontinued operations - depreciation and minority interests		2,9
Extinguishment of debt		3,0
Impairment charges related to real estate assets		4,0
Income from investment in land sales, net		(8,5
Gain on joint venture of properties, net		
Minority interests		(4,6
Cumulative effect of a change in accounting principle, net of minority interests		3
Non-cash compensation		8
Equity in (earnings) loss from unconsolidated companies:		
Office Properties		(3,8
Resort/Hotel Properties		2
Residential Development Properties		1,1
Temperature-Controlled Logistics Properties		4,5
Other		3
Distributions received from unconsolidated companies:		
Office Properties		4,4
Residential Development Properties		
Temperature-Controlled Logistics Properties		1,8
Other		9
Change in assets and liabilities, net of consolidations, acquisitions and dispositions:		
Restricted cash and cash equivalents		52,6
Accounts receivable		(6,9
Deferred rent receivable		(12,9
Income tax asset - current and deferred, net		(22,2
Other assets		(11,0
Accounts payable, accrued expenses and other liabilities		15,2
Net cash provided by operating activities	\$	75,3

CASH FLOWS FROM INVESTING ACTIVITIES:

Net cash impact of consolidation of previously unconsolidated companies	\$	3
Proceeds from property sales		113,8
Acquisition of investment properties		(193,2
Development of investment properties		(3,8
Property improvements - Office Properties		(9,0
Property improvements - Resort/Hotel Properties		(22,2
Tenant improvement and leasing costs - Office Properties		(68,1
Residential Development Properties Investments		(28,3
Decrease (increase) in restricted cash and cash equivalents		92,3
Purchases of defeasance investments and other securities		(195,7
Proceeds from defeasance investment maturities		8,8

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Return of investment in unconsolidated companies:	
Office Properties	2,2
Resort/Hotel Properties	1,2
Residential Development Properties	
Temperature-Controlled Logistics Properties	90,7
Other	2
Investment in unconsolidated companies:	
Office Properties	(10,0
Residential Development Properties	(9
Temperature-Controlled Logistics Properties	(2,4
Other	(2,6
Decrease in notes receivable	4,8

Net cash used in investing activities	\$ (221,9

CASH FLOWS FROM FINANCING ACTIVITIES:	
Debt financing costs	\$ (8,2
Borrowings under Credit Facility	440,0
Payments under Credit Facility	(371,5
Notes payable proceeds	454,6
Notes payable payments	(386,5
Residential Development Properties notes payable borrowings	77,7
Residential Development Properties notes payable payments	(62,4
Amortization of debt premiums	(1,7
Obligation related to property financing transaction	79,9
Capital distributions - joint venture partner	(6,3
Capital contributions - joint venture partner	2,1
Proceeds from exercise of share options	3
Treasury shares purchase under compensation plan	
Issuance of preferred shares - Series A	71,0
Series A Preferred Share distributions	(17,9
Series B Preferred Share distributions	(6,0
Dividends and unitholder distributions	(131,7

Net cash provided by (used in) financing activities	\$ 133,0

DECREASE IN CASH AND CASH EQUIVALENTS	\$ (13,5
CASH AND CASH EQUIVALENTS,	
Beginning of period	78,0

CASH AND CASH EQUIVALENTS,	
End of period	\$ 64,5
	=====

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

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CRESCENT REAL ESTATE EQUITIES COMPANY NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. ORGANIZATION AND BASIS OF PRESENTATION

Crescent Real Estate Equities Company ("Crescent Equities") operates as a real estate investment trust for federal income tax purposes (a "REIT") and, together with its subsidiaries, provides management, leasing and development services for some of its properties.

The term "Company" includes, unless the context otherwise indicates,

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Crescent Equities, a Texas real estate investment trust, and all of its direct and indirect subsidiaries.

The direct and indirect subsidiaries of Crescent Equities at September 30, 2004 included:

- CRESCENT REAL ESTATE EQUITIES LIMITED PARTNERSHIP
The "Operating Partnership."
- CRESCENT REAL ESTATE EQUITIES, LTD.
The "General Partner" of the Operating Partnership.
- SUBSIDIARIES OF THE OPERATING PARTNERSHIP AND THE GENERAL PARTNER

Crescent Equities conducts all of its business through the Operating Partnership and its other subsidiaries. The Company is structured to facilitate and maintain the qualification of Crescent Equities as a REIT.

The following table shows the consolidated subsidiaries of the Company that owned or had an interest in real estate assets and the real estate assets that each subsidiary owned or had an interest in as of September 30, 2004.

Operating Partnership	Partnership Wholly-owned assets - The Avallon IV, Datran Center (two office properties), Houston Center (three office properties and the Houston Center Shops), and Dupont Centre. These properties are included in the Company's Office Segment. Non wholly-owned assets, consolidated - 301 Congress Avenue (50% interest) and Fountain Place (0.1% interest), included in the Company's Office Segment. Sonoma Mission Inn (80.1% interest), included in the Company's Resort/Hotel Segment. See Note 6, "Other Transactions," for a description of the Fountain Place Office Property transaction. Non wholly-owned assets, unconsolidated - Bank One Center (50% interest), Bank One Tower (20% interest), Three Westlake Park (20% interest), Four Westlake Park (20% interest), Miami Center (40% interest), 5 Houston Center (25% interest), BriarLake Plaza (30% interest) and Five Post Oak Park (30% interest). These properties are included in the Company's Office Segment. Temperature-Controlled Logistics Properties (40% interest in 87 properties), included in the Company's Temperature-Controlled Logistics Segment.
Hughes Center Entities(1)	Wholly-owned assets - Hughes Center Properties (seven office properties each in a separate limited liability company). These properties are included in the Company's Office Segment.

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	Non wholly-owned asset, consolidated - 3770 Hughes Parkway (67% interest), included in the Company's Office Segment.
Crescent Real Estate Funding I, L.P. ("Funding I")	Wholly-owned assets - The Aberdeen, The Avallon I, II & III, Carter Burgess Plaza, The Citadel, The Crescent Atrium, The Crescent Office Towers, Regency Plaza One, Waterside Commons and 125 E. John Carpenter Freeway. These properties are included in the Company's Office Segment.
Crescent Real Estate Funding III, IV and V, L.P. ("Funding III, IV and V")(2)	Wholly-owned assets - Greenway Plaza Office Properties (ten Office Properties). These properties are included in the Company's Office Segment. Renaissance Houston Hotel is included in the Company's Resort/Hotel Segment.
Crescent Real Estate Funding VI, L.P. ("Funding VI")	Wholly-owned asset - Canyon Ranch - Lenox, included in the Company's Resort/Hotel Segment.
Crescent Real Estate Funding VIII, L.P. ("Funding VIII")	Wholly-owned assets - The Addison, Austin Centre, The Avallon V, Chancellor Park, 816 Congress, Greenway I & IA (two office properties), Greenway II, Johns Manville Plaza, Palisades Central I, Palisades Central II, Stemmons Place, Trammell Crow Center(3), 3333 Lee Parkway, 44 Cook and 55 Madison. These properties are included in the Company's Office Segment. The Canyon Ranch - Tucson, Omni Austin Hotel, and Ventana Inn & Spa, all of which are included in the Company's Resort/Hotel Segment.
Crescent Real Estate Funding X, L.P. ("Funding X")	Wholly-owned assets - Post Oak Central (three Office Properties). These properties are included in the Company's Office Segment.

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CRESCENT REAL ESTATE EQUITIES COMPANY NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Crescent Real Estate Funding XII, L.P. ("Funding XII")	Wholly-owned assets - Albuquerque Plaza, Barton Oaks Plaza, Briargate Office and Research Center, MacArthur Center I & II, Stanford Corporate Center, and Two Renaissance Square. These properties are included in the Company's Office Segment. The Hyatt Regency Albuquerque and the Park Hyatt Beaver Creek Resort & Spa. These properties are included in the Company's Resort/Hotel Segment.
Crescent 707 17th Street, L.L.C	Wholly-owned assets - 707 17th Street, included in the Company's Office Segment, and The Denver Marriott City Center, included in the Company's Resort/Hotel Segment.

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Crescent Alhambra, L.L.C.	Wholly-owned asset - Alhambra Plaza (two Office Properties), included in the Company's Office Segment.
Crescent Spectrum Center, L.P.	Non wholly-owned asset, consolidated - Spectrum Center (approximately 100% interest), included in the Company's Office Segment.
Crescent Colonnade, L.L.C.	Wholly-owned asset - The BAC-Colonnade Building, included in the Company's Office Segment.
Mira Vista Development Corp. ("MVDC")	Non wholly-owned asset, consolidated - Mira Vista (98% interest), included in the Company's Residential Development Segment.
Houston Area Development Corp. ("HADC")	Non wholly-owned assets, consolidated - Falcon Point (98% interest) and Spring Lakes (98% interest). These properties are included in the Company's Residential Development Segment.
Desert Mountain Development Corporation ("DMDC")	Non wholly-owned assets, consolidated - Desert Mountain (93% interest), included in the Company's Residential Development Segment.
Crescent Resort Development Inc. ("CRDI")	Non wholly-owned assets, consolidated - Brownstones (64% interest), Creekside at Riverfront (64% interest), Cresta (60% interest), Delgany (64% interest), Eagle Ranch (60% interest), Gray's Crossing (71% interest), Horizon Pass (64% interest), Hummingbird (64% interest), Main Street Station (30% interest), Northstar (57% interest), Old Greenwood (71% interest), Park Place at Riverfront (64% interest), Park Tower at Riverfront (64% interest), Riverbend (60% interest), Riverfront Park (64% interest). These properties are included in the Company's Residential Development Segment.
	Non wholly-owned assets, unconsolidated - Blue River Land Company, L.L.C. - Three Peaks (30% interest) and EW Deer Valley, L.L.C. (42% interest), included in the Company's Residential Development Segment.
Crescent TRS Holdings Corp.	Non wholly-owned assets, unconsolidated - two quarries (56% interest). These properties are included in the Company's Temperature-Controlled Logistics Segment.

- (1) In addition, the Company owns nine retail parcels located in Hughes Center.
- (2) Funding III owns nine of the ten office properties in the Greenway Plaza

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office portfolio and the Renaissance Houston Hotel; Funding IV owns the central heated and chilled water plant building located at Greenway Plaza; and Funding V owns 9 Greenway, the remaining office property in the Greenway Plaza office portfolio.

- (3) The Company owns the economic interest in Trammell Crow Center through its ownership of fee simple title to the Property (subject to a ground lease and a leasehold estate regarding the building) and two mortgage notes encumbering the leasehold interests in the land and the building.

See Note 8, "Investments in Unconsolidated Companies," for a table that lists the Company's ownership in significant unconsolidated joint ventures and investments as of September 30, 2004.

See Note 9, "Notes Payable and Borrowings Under Credit Facility," for a list of certain other subsidiaries of the Company, all of which are consolidated in the Company's financial statements and were formed primarily for the purpose of obtaining secured debt or joint venture financing.

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CRESCENT REAL ESTATE EQUITIES COMPANY NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SEGMENTS

The assets and operations of the Company were divided into four investment segments at September 30, 2004, as follows:

- Office Segment;
- Resort/Hotel Segment;
- Residential Development Segment; and
- Temperature-Controlled Logistics Segment.

Within these segments, the Company owned in whole or in part the following real estate assets (the "Properties") as of September 30, 2004:

- OFFICE SEGMENT consisted of 75 office properties (collectively referred to as the "Office Properties"), located in 27 metropolitan submarkets in seven states, with an aggregate of approximately 29.9 million net rentable square feet. Sixty-five of the Office Properties are wholly-owned and ten are owned through joint ventures, two of which are consolidated and eight of which are unconsolidated.
- RESORT/HOTEL SEGMENT consisted of five luxury and destination fitness resorts and spas with a total of 1,036 rooms/guest nights and four upscale business-class hotel properties with a total of 1,771 rooms (collectively referred to as the "Resort/Hotel Properties"). Eight of the Resort/Hotel Properties are wholly-owned and one is owned through a joint venture that is consolidated.
- RESIDENTIAL DEVELOPMENT SEGMENT consisted of the Company's ownership of common stock representing interests of 98% to 100% in four residential development corporations (collectively referred to as the "Residential Development Corporations"), which in turn, through partnership arrangements, owned in whole or in part 28 upscale residential development properties (collectively referred to as the

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"Residential Development Properties").

- TEMPERATURE-CONTROLLED LOGISTICS SEGMENT consisted of the Company's 40% interest in Vornado Crescent Portland Partnership (the "Temperature-Controlled Logistics Partnership") and a 56% non-controlling interest in the Vornado Crescent Carthage and KC Quarry L.L.C. ("VCQ"). The Temperature-Controlled Logistics Partnership owns all of the common stock, representing substantially all of the economic interest, of AmeriCold Realty Trust (the "Temperature-Controlled Logistics Corporation"), a REIT. As of September 30, 2004, the Temperature-Controlled Logistics Corporation directly or indirectly owned 87 temperature-controlled logistics properties (collectively referred to as the "Temperature-Controlled Logistics Properties") with an aggregate of approximately 440.7 million cubic feet (17.5 million square feet) of warehouse space. As of September 30, 2004, VCQ owned two quarries and the related land. The Company accounts for its interests in the Temperature-Controlled Logistics Partnership and in VCQ as unconsolidated equity entities.

See Note 3, "Segment Reporting," for a table showing selected financial information for each of these investment segments for the three and nine months ended September 30, 2004 and 2003, and total assets, consolidated property level financing, consolidated other liabilities, and minority interests for each of these investment segments at September 30, 2004 and December 31, 2003.

See Note 17, "Subsequent Events," for a discussion of (i) the Company's joint venture transaction related to three of its Office Properties, (ii) the sale of one of its business-class hotel properties and (iii) the restructuring of the Company's investment in the Temperature-Controlled Logistics Segment.

BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three- and nine-month periods ended September 30, 2004 are not necessarily indicative of the results that may be expected for the year ended December 31, 2004.

The consolidated balance sheet at December 31, 2003 has been derived from the audited consolidated financial statements at that date but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements.

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CRESCENT REAL ESTATE EQUITIES COMPANY NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

You should read these consolidated financial statements in conjunction with the consolidated financial statements and footnotes thereto in the Company's annual report on Form 10-K for the year ended December 31, 2003.

Certain amounts in prior period financial statements have been reclassified to conform to current period presentation.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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This section should be read in conjunction with the more detailed information regarding the Company's significant accounting policies contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2003.

ADOPTION OF NEW ACCOUNTING STANDARD

EITF 03-1. At the March 17-18, 2004 meeting, consensus was reached by the FASB Emerging Issues Task Force on EITF 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments." The Consensus applies to investments in debt and equity securities within the scope of SFAS Nos. 115, "Accounting for Certain Investments in Debt and Equity Securities," and 124, "Accounting for Certain Investments Held by Not-for-Profit Organizations." It also applies to investments in equity securities that are both outside SFAS No. 115's scope and not accounted for under the equity method. The Task Force reached a consensus that certain quantitative and qualitative disclosures should be required for securities that are impaired at the balance sheet date but for which an other - than-temporary impairment has not been recognized. The new impairment guidance creates a model that calls for many judgments and additional evidence gathering in determining whether or not securities are other-than-temporarily impaired and lists some of these impairment indicators. The impairment accounting guidance is effective for periods beginning after June 15, 2004 and the disclosure requirements for annual reporting periods are effective for periods ending after June 15, 2004. The Company adopted EITF 03-1 effective July 1, 2004 and it had no impact on the Company's financial condition or its results of operations.

SIGNIFICANT ACCOUNTING POLICIES

CONSOLIDATION OF VARIABLE INTEREST ENTITIES. On January 15, 2003, the FASB approved the issuance of Interpretation 46, "Consolidation of Variable Interest Entities," ("FIN 46"), an interpretation of Accounting Research Bulletin No. 51, "Consolidated Financial Statements." In December 2003, the FASB issued FIN 46R, "Consolidation of Variable Interest Entities" ("FIN 46R"), which amended FIN 46. Under FIN 46R, consolidation requirements are effective immediately for new Variable Interest Entities ("VIEs") created after January 31, 2003. The consolidation requirements apply to existing VIEs for financial periods ending after March 15, 2004, except for special purpose entities which had to be consolidated by December 31, 2003. VIEs are generally a legal structure used for business enterprises that either do not have equity investors with voting rights, or have equity investors that do not provide sufficient financial resources for the entity to support its activities. The objective of the new guidance is to improve reporting by addressing when a company should include in its financial statements the assets, liabilities and activities of other entities such as VIEs. FIN 46R requires VIEs to be consolidated by a company if the company is subject to a majority of the expected losses of the VIE's activities or entitled to receive a majority of the entity's expected residual returns or both.

The adoption of FIN 46R did not have a material impact to the Company's financial condition or results of operations. Due to the adoption of this Interpretation and management's assumptions in application of the guidelines stated in the Interpretation, the Company has consolidated GDW LLC, a subsidiary of DMDC, as of December 31, 2003 and Elijah Fulcrum Fund Partners, L.P. ("Elijah") as of January 1, 2004. Elijah is a limited partnership whose purpose is to invest in the SunTx Fulcrum Fund, L.P. SunTx Fulcrum Fund, L.P.'s objective is to invest in a portfolio of acquisitions that offer the potential for substantial capital appreciation. While it was determined that one of the Company's unconsolidated joint ventures, Main Street Partners, L.P., and its investments in Canyon Ranch Las Vegas, L.L.C., CR License, L.L.C. and CR License II, L.L.C. ("Canyon Ranch Entities") are VIEs under FIN 46R, the Company is not the primary beneficiary and is not required to consolidate these entities under

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other GAAP. The Company's maximum exposure to loss is limited to its equity investment of approximately \$57.7 million in Main Street Partners, L.P. and \$5.1 million in the Canyon Ranch Entities at September 30, 2004.

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CRESCENT REAL ESTATE EQUITIES COMPANY NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

During 2004, the Company entered into three separate exchange agreements with a third party intermediary. The first exchange agreement included two parcels of undeveloped land, the second exchange agreement included the 3930 Hughes Parkway Office Property, and the third exchange agreement included The Alhambra Office Property. The agreements were for a maximum term of 180 days and allow the Company to pursue favorable tax treatment on other properties sold by the Company within this period. During the 180-day periods, which ended or will end on August 28, 2004, November 6, 2004, and February 2, 2005, respectively, the third party intermediary is the legal owner of the properties, although the Company controls the properties, retains all of the economic benefits and risks associated with these properties and indemnifies the third party intermediary and, therefore, the Company fully consolidates these properties. The Company took or will take legal ownership of the properties no later than on the expiration of the respective 180-day period.

STOCK-BASED COMPENSATION. Effective January 1, 2003, the Company adopted the fair value expense recognition provisions of SFAS No. 123, "Accounting for Stock-Based Compensation," on a prospective basis as permitted by SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure," which requires that the fair value of stock options at the date of grant be amortized ratably into expense over the appropriate vesting period. During the nine months ended September 30, 2004, the Company granted stock options and recognized compensation expense that was not significant to its results of operations. With respect to the Company's stock options which were granted prior to 2003, the Company accounted for stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and related Interpretations ("APB No. 25"). Had compensation cost been determined based on the fair value at the grant dates for awards under the Plans consistent with SFAS No. 123, the Company's net loss and loss per share would have been reduced to the following pro forma amounts:

	FOR THE THREE MONTHS ENDED SEPTEMBER 30,		
(in thousands, except per share amounts)	2004	2003	
Net loss available to common shareholders, as reported	\$ (18,683)	\$ (3,305)	\$
Add: Stock-based employee compensation expense included in reported net income	355	15	
Deduct: total stock-based employee compensation expense determined under fair value based method for all awards, net of minority interest	(838)	(594)	
Pro forma net loss	\$ (19,166)	\$ (3,884)	\$
Loss per share:			
Basic/Diluted - as reported	\$ (0.19)	\$ (0.03)	\$
Basic/Diluted - pro forma	\$ (0.19)	\$ (0.04)	\$

CRESCENT REAL ESTATE EQUITIES COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

MARKETABLE SECURITIES. The Company has classified and recorded its marketable securities in accordance with SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities." Realized gains or losses on the sale of securities are recorded based on specific identification. When a decline in the fair value of marketable securities is determined to be other-than-temporary, the cost basis is written down to fair value and the amount of the write-down is included in earnings for the applicable period. Investments in securities with no readily determinable market value are reported at cost, as they are not considered marketable under SFAS No. 115, and total \$5.5 million at September 30, 2004 and December 31, 2003.

The following tables present the cost, fair value and unrealized gains and losses as of September 30, 2004 and December 31, 2003 and the realized gains and change in Accumulated Other Comprehensive Income ("OCI") for the nine months ended September 30, 2004 and 2003 for the Company's marketable securities.

(in thousands) TYPE OF SECURITY	AS OF SEPTEMBER 30, 2004			AS OF DECEMBER 31, 2003		
	COST	FAIR VALUE	UNREALIZED GAIN/ (LOSS)	COST	FAIR VALUE	UN GA
Held to maturity(1)	\$ 170,589	\$ 169,042	\$ (1,547)	\$ 9,620	\$ 9,621	\$
Trading(2)	7,963	8,270	N/A	4,473	4,714	
Available for sale(3)	24,204	24,908	705	2,278	2,278	
Total	\$ 202,756	\$ 202,220	\$ (842)	\$ 16,371	\$ 16,613	\$

(in thousands) TYPE OF SECURITY	FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2004		FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2003	
	REALIZED GAIN/ (LOSS)	CHANGE IN OCI	REALIZED GAIN/ (LOSS)	CHANGE IN OCI
Held to maturity(1)	\$ -	N/A	\$ -	\$ N/A
Trading(2)	367	N/A	-	N/A
Available for sale(3)	6	705	(502)	514
Total	\$ 373	\$ 705	\$ (502)	\$ 514

- (1) Held to maturity securities are carried at amortized cost and consist of U.S. Treasury and government sponsored agency securities purchased for the sole purpose of funding debt service payments on the LaSalle Note II. See Note 9, "Notes Payable and Borrowings Under Credit Facility," for additional information on the defeasance of the LaSalle Note II.

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- (2) Trading securities consist of primarily marketable securities purchased in connection with the Company's dividend incentive unit program. These securities are included in "Other assets, net" in the accompanying Consolidated Balance Sheets and are marked to market value on a monthly basis with the change in fair value recognized in earnings.
- (3) Available for sale securities consist of marketable securities which the Company intends to hold for an indefinite period of time. These securities consist of \$18.3 million of bonds and \$6.6 million of preferred stock which are included in "Other assets, net" in the accompanying Consolidated Balance Sheets and are marked to market value on a monthly basis with the corresponding unrealized gain or loss recorded in OCI.

In July 2004, Fresh Choice, Inc., in which the Company owns \$5.5 million Series B Preferred shares reported at cost at September 30, 2004 and December 31, 2003, filed for protection under Chapter 11 of the U.S. Bankruptcy Court in order to facilitate a reorganization and restructuring. At September 5, 2004, the accrued liquidation preference on the Series B Preferred shares was \$9.3 million. Based on the Company's evaluation of its preferred interest in Fresh Choice, the Company estimates the value of its shares at a minimum to be equal to the investment balance of \$5.5 million.

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CRESCENT REAL ESTATE EQUITIES COMPANY NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

EARNINGS PER SHARE. SFAS No. 128, "Earnings Per Share," ("EPS") specifies the computation, presentation and disclosure requirements for earnings per share.

Basic EPS is computed by dividing net income available to common stockholders by the weighted average number of shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock, where such exercise or conversion would result in a lower EPS amount. The Company presents both basic and diluted earnings per share.

The following tables present reconciliations for the three and nine months ended September 30, 2004 and 2003 of basic and diluted earnings per share from "Loss before discontinued operations and cumulative effect of a change in accounting principle" to "Net loss available to common shareholders." The table also includes weighted average shares on a basic and diluted basis, which for the periods presented, are the same.

	FOR THE THREE MONTHS E		
	2004		
(in thousands, except per share amounts)	Income (Loss)	Wtd. Avg. Shares (1)	Per Share Amount
BASIC/DILUTED EPS -			
Loss before discontinued operations and cumulative effect of a change in accounting principle	\$ (12,311)	99,024	
Series A Preferred Share distributions	(5,991)		
Series B Preferred Share distributions	(2,019)		

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Loss available to common shareholders			
before discontinued operations and cumulative			
effect of a change in accounting principle	\$ (20,321)	99,024	\$ (0.21)
Income from discontinued operations, net of minority interests	1,967		0.02
Impairment charges related to real estate assets from			
discontinued operations, net of minority interests	(297)		-
Loss on real estate from discontinued operations, net of			
minority interests	(32)		-
Cumulative effect of a change in accounting principle	-		-
	-----	-----	-----
Net loss available to common shareholders	\$ (18,683)	99,024	\$ (0.19)
	=====	=====	=====

(1) Anti-dilutive shares not included are 112 and 10 for the three months ended September 30, 2004 and 2003, respectively.

	FOR THE THREE MONTHS E		

	2004		

(in thousands, except per share amounts)	Income	Wtd. Avg.	Per Share
-----	(Loss)	Shares (1)	Amount
	-----	-----	-----
BASIC/DILUTED EPS -			
Loss before discontinued operations and cumulative effect			
of a change in accounting principle	\$ (31,944)	99,013	
Series A Preferred Share distributions	(17,733)		
Series B Preferred Share distributions	(6,057)		
	-----	-----	-----
Loss available to common shareholders			
before discontinued operations and cumulative			
effect of a change in accounting principle	\$ (55,734)	99,013	\$ (0.56)
Income from discontinued operations, net of minority interests	6,192		0.06
Impairment charges related to real estate assets from			
discontinued operations, net of minority interests	(2,715)		(0.03)
Loss on real estate from discontinued operations, net of			
minority interests	(2,152)		(0.02)
Cumulative effect of a change in accounting principle	(363)		-
	-----	-----	-----
Net loss available to common shareholders	\$ (54,772)	99,013	\$ (0.55)
	=====	=====	=====

(1) Anti-dilutive shares not included are 170 and 6 for the nine months ended September 30, 2004 and 2003, respectively.

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SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION: (in thousands)	FOR THE NINE MONTHS ENDING SEPTEMBER 31, 2004	
-----	-----	-----
Interest paid on debt	\$ 121,622	\$
Interest capitalized - Resort/Hotel	278	
Interest capitalized - Residential Development	11,090	
Additional interest paid in conjunction with cash flow hedges	8,935	
	-----	-----
Total interest paid	\$ 141,925	\$
	=====	=====
Cash paid for income taxes	\$ 8,406	\$
	=====	=====

SUPPLEMENTAL SCHEDULE OF NON CASH ACTIVITIES:

Conversion of Operating Partnership units to common shares with resulting reduction in minority interest and increases in common shares and additional paid-in capital	\$ -	\$
Assumption of debt in conjunction with acquisitions of Office Properties	139,807	
Non-cash compensation	962	
Financed sale of land parcel	4,878	
Financed purchase of land parcel	7,500	

SUPPLEMENTAL SCHEDULE OF 2003 CONSOLIDATION OF DBL, MVDC, HADC, AND 2004 CONSOLIDATION OF ELIJAH:

Net investment in real estate	\$ -	\$
Accounts receivable, net	(848)	
Investments in unconsolidated companies	(2,478)	
Notes receivable, net	4,363	
Income tax asset - current and deferred, net	(274)	
Other assets, net	-	
Notes payable	-	
Accounts payable, accrued expenses and other liabilities	-	
Minority interest - consolidated real estate partnerships	(140)	
Other comprehensive income, net of tax	139	
Cumulative effect of a change in accounting principle	(428)	
	-----	-----
Increase in cash	\$ 334	\$
	=====	=====

3. SEGMENT REPORTING

For purposes of segment reporting as defined in SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information," the Company currently has four major investment segments based on property type: the Office Segment; the Resort/Hotel Segment; the Residential Development Segment; and the Temperature-Controlled Logistics Segment. Management utilizes this segment structure for making operating decisions and assessing performance.

The Company uses funds from operations ("FFO") as the measure of segment profit or loss. FFO, as used in this document, is based on the definition adopted by the Board of Governors of the National Association of Real Estate Investment Trusts ("NAREIT") and means:

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- Net Income (Loss) - determined in accordance with GAAP;
- excluding gains (losses) from sales of depreciable operating property;
- excluding extraordinary items (as defined by GAAP);
- plus depreciation and amortization of real estate assets; and
- after adjustments for unconsolidated partnerships and joint ventures.

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CRESCENT REAL ESTATE EQUITIES COMPANY NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The Company calculates FFO available to common shareholders - diluted in the same manner, except that Net Income (Loss) is replaced by Net Income (Loss) Available to Common Shareholders and the Company includes the effect of Operating Partnership unitholder minority interests.

NAREIT developed FFO as a relative measure of performance of an equity REIT to recognize that income-producing real estate historically has not depreciated on the basis determined under GAAP. The Company considers FFO available to common shareholders - diluted and FFO appropriate measures of performance for an equity REIT and for its investment segments. However, FFO available to common shareholders - diluted and FFO should not be considered as alternatives to net income determined in accordance with GAAP as an indication of the Company's operating performance.

The Company's measures of FFO available to common shareholders - diluted and FFO may not be comparable to similarly titled measures of other REITs if those REITs apply the definition of FFO in a different manner than the Company.

Selected financial information related to each segment for the three and nine months ended September 30, 2004 and 2003, and total assets, consolidated property level financing, consolidated other liabilities, and minority interests for each of the segments at September 30, 2004 and December 31, 2003, are presented below:

SELECTED FINANCIAL INFORMATION:

(in thousands)	FOR THE THREE MONTHS ENDED SEPTEMBER			
	OFFICE SEGMENT (1)	RESORT/HOTEL SEGMENT	RESIDENTIAL DEVELOPMENT SEGMENT (2)	TEMPERATURE CONTROLLED LOGISTICS SEGMENT
Total Property revenue	\$ 128,331	\$ 46,986	\$ 60,595	\$ -
Total Property expense	62,418	39,479	54,480	-
Income from Property Operations	\$ 65,913	\$ 7,507	\$ 6,115	\$ -
Total other income (expense)	(34,238)	(5,993)	(8,310)	(906)
Minority interests and income taxes	(512)	2,454	3,469	-
Discontinued operations -income, loss				

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on real estate and impairment charges related to real estate assets	(341)	2,642	103	-
Net income (loss)	\$ 30,822	\$ 6,610	\$ 1,377	\$ (906)
Depreciation and amortization of real estate assets	\$ 35,141	\$ 5,662	\$ 2,181	\$ -
(Gain) loss on property sales, net	164	-	(126)	-
Impairment charges related to real estate assets	-	-	2,497	-
Adjustments for investment in unconsolidated companies	2,283	-	(2,150)	5,768
Unitholder minority interest	-	-	-	-
Series A Preferred share distributions	-	-	-	-
Series B Preferred share distributions	-	-	-	-
Adjustments to reconcile net income (loss) to funds from operations - diluted	\$ 37,588	\$ 5,662	\$ 2,402	\$ 5,768
Funds from operations available to common shareholders before impairment charges related to real estate assets - diluted	\$ 68,410	\$ 12,272	\$ 3,779	\$ 4,862
Impairment charges related to real estate assets	-	-	(2,497)	-
Funds from operations available to common shareholders after impairment charges related to real estate assets - diluted	\$ 68,410	\$ 12,272	\$ 1,282	\$ 4,862

See footnotes to the following table.

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CRESCENT REAL ESTATE EQUITIES COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SELECTED FINANCIAL INFORMATION:

(in thousands)	FOR THE THREE MONTHS ENDED SEPTEMBER			
	OFFICE SEGMENT (1)	RESORT/HOTEL SEGMENT	RESIDENTIAL DEVELOPMENT SEGMENT (2)	TEMPERATURE CONTROLLED LOGISTICS SEGMENT
Total Property revenue	\$ 123,155	\$ 42,319	\$ 34,936	\$ -
Total Property expense	58,299	35,397	34,975	-
Income from Property Operations	\$ 64,856	\$ 6,922	\$ (39)	\$ -
Total other income (expense)	(21,254)	(4,988)	(670)	(9)
Minority interests and income taxes	7	1,481	2,347	-

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Discontinued operations -income, loss on real estate and impairment charges related to real estate assets	(1,177)	1,600	10	
Net income (loss)	\$ 42,432	\$ 5,015	\$ 1,648	\$ (9,111)
Depreciation and amortization of real estate assets	\$ 32,438	\$ 6,062	\$ 1,117	\$ 1,117
(Gain) loss on property sales, net	28	-	-	-
Impairment charges related to real estate assets	-	-	-	-
Adjustments for investment in unconsolidated companies	(1,613)	394	8	5,111
Unitholder minority interest	-	-	-	-
Series A Preferred share distributions	-	-	-	-
Series B Preferred share distributions	-	-	-	-
Adjustments to reconcile net income (loss) to funds from operations - diluted	\$ 30,853	\$ 6,456	\$ 1,125	\$ 5,111
Funds from operations available to common shareholders before impairment charges related to real estate assets - diluted	\$ 73,285	\$ 11,471	\$ 2,773	\$ 4,111
Impairment charges related to real estate assets	-	-	-	-
Funds from operations available to common shareholders after impairment charges related to real estate assets - diluted	\$ 73,285	\$ 11,471	\$ 2,773	\$ 4,111

See footnotes to the following table.

SELECTED FINANCIAL INFORMATION:

(in thousands)	FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2014			
	OFFICE SEGMENT (1)	RESORT/HOTEL SEGMENT	RESIDENTIAL DEVELOPMENT SEGMENT (2)	TEMPERATURE CONTROLLED LOGISTICS SEGMENT
Total Property revenue	\$ 384,564	\$ 137,241	\$ 163,875	\$ 1,111
Total Property expense	182,625	115,382	146,803	1,111
Income from Property Operations	\$ 201,939	\$ 21,859	\$ 17,072	\$ 1,111
Total other income (expense)	(94,131)	(16,738)	(15,794)	(4,511)
Minority interests and income taxes	(1,230)	6,531	8,308	-
Discontinued operations -income, loss on real estate and impairment charges related to real estate assets	(4,434)	6,611	149	-
Cumulative effect of a change in accounting principle	-	-	-	-

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Net income (loss)	\$ 102,144	\$ 18,263	\$ 9,735	\$ (4,5
Depreciation and amortization of real estate assets	\$ 97,205	\$ 17,030	\$ 5,115	\$
(Gain) loss on property sales, net	2,319	-	(127)	
Impairment charges related to real estate assets	2,852	-	2,497	
Adjustments for investment in unconsolidated companies	7,188	-	(2,099)	17,3
Unitholder minority interest	-	-	-	
Series A Preferred share distributions	-	-	-	
Series B Preferred share distributions	-	-	-	
Adjustments to reconcile net income (loss) to funds from operations available to common shareholders - diluted	\$ 109,564	\$ 17,030	\$ 5,386	\$ 17,3
Funds from operations available to common shareholders before impairment charges related to real estate assets - diluted	\$ 211,708	\$ 35,293	\$ 15,121	\$ 12,8
Impairment charges related to real estate assets	(2,852)	-	(2,497)	
Funds from operations available to common shareholders after impairment charges related to real estate assets - diluted	\$ 208,856	\$ 35,293	\$ 12,624	\$ 12,8

See footnotes to the following table.

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CRESCENT REAL ESTATE EQUITIES COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SELECTED FINANCIAL INFORMATION:

(in thousands)	FOR THE NINE MONTHS ENDED SEPTEMBER			
	OFFICE SEGMENT (1)	RESORT/HOTEL SEGMENT	RESIDENTIAL DEVELOPMENT SEGMENT (2)	TEMPERATURE CONTROLLED LOGISTICS SEGMENT
Total Property revenue	\$ 364,137	\$ 132,873	\$ 140,631	\$
Total Property expense	175,750	108,706	131,977	
Income from Property Operations	\$ 188,387	\$ 24,167	\$ 8,654	\$
Total other income (expense)	(71,493)	(12,187)	(3,336)	
Minority interests and income taxes	(267)	4,031	4,671	
Discontinued operations -income, loss on real estate and impairment charges				

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related to real estate assets	(10,340)	4,659	(1)	
Net income (loss)	\$ 106,287	\$ 20,670	\$ 9,988	\$ 1
Depreciation and amortization of real estate assets	\$ 87,829	\$ 17,645	\$ 3,543	\$
(Gain) loss on property sales, net	447	-	-	
Impairment charges related to real estate assets	16,200	-	-	
Adjustments for investment in unconsolidated companies	3,805	1,143	235	16,1
Unitholder minority interest	-	-	-	
Series A Preferred share distributions	-	-	-	
Series B Preferred share distributions	-	-	-	
Adjustments to reconcile net income (loss) to funds from operations - diluted	\$ 108,281	\$ 18,788	\$ 3,778	\$ 16,1
Funds from operations available to common shareholders before impairment charges related to real estate assets - diluted	\$ 214,568	\$ 39,458	\$ 13,766	\$ 16,2
Impairment charges related to real estate assets	(16,200)	-	-	
Funds from operations available to common shareholders after impairment charges related to real estate assets - diluted	\$ 198,368	\$ 39,458	\$ 13,766	\$ 16,2

See footnotes to the following table.

(IN MILLIONS)	OFFICE SEGMENT	RESORT/HOTEL SEGMENT	RESIDENTIAL DEVELOPMENT SEGMENT (2) (4)	TEMPERATURE-CONTROLLED LOGISTICS SEGMENT
TOTAL ASSETS BY SEGMENT: (5) (6)				
Balance at September 30, 2004	\$ 2,692	\$ 500	\$ 834	\$ 206
Balance at December 31, 2003	2,503	468	707	300
CONSOLIDATED PROPERTY LEVEL FINANCING:				
Balance at September 30, 2004	(1,437)	(143)	(103)	-
Balance at December 31, 2003	(1,459)	(138)	(88)	-
CONSOLIDATED OTHER LIABILITIES:				
Balance at September 30, 2004	(188)	(43)	(178)	-
Balance at December 31, 2003	(120)	(27)	(109)	-
MINORITY INTERESTS:				
Balance at September 30, 2004	(9)	(6)	(29)	-
Balance at December 31, 2003	(9)	(7)	(31)	-

(1) The property revenue includes lease termination fees (net of the write-off of deferred rent receivables) of approximately \$1.3 million and \$5.0 million for the three months ended September 30, 2004 and 2003,

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respectively and \$8.5 million and \$7.9 million for the nine months ended September 30, 2004 and 2003, respectively.

- (2) The Company sold its interest in The Woodlands Land Development Company, L.P. on December 31, 2003.
- (3) For purposes of this Note, Corporate and Other includes the total of: income from investment land sales, net, interest and other income, corporate general and administrative expense, interest expense, amortization of deferred financing costs, extinguishment of debt, other expenses, and equity in net income of unconsolidated companies-other.
- (4) The Company's net book value for the Residential Development Segment includes total assets, consolidated property level financing, consolidated other liabilities and minority interest totaling \$524 million at September 30, 2004. The primary components of net book value are \$361 million for CRDI, consisting of Tahoe Mountain Resort properties of \$215 million, Denver development properties of \$62 million and Colorado Mountain development properties of \$84 million, \$135 million for Desert Mountain and \$28 million for other land development properties.
- (5) Total assets by segment are inclusive of investments in unconsolidated companies.
- (6) Non-income producing land held for investment or development of \$82.2 million by segment is as follows: Corporate \$75.3 million and Resort/Hotel \$6.9 million.
- (7) Includes U.S. Treasury and government sponsored agency securities of \$170.6 million.
- (8) Inclusive of Corporate bonds, credit facility, the \$75 million Fleet Term Loan, The Rouse Company Note, and Funding II defeased debt.

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CRESCENT REAL ESTATE EQUITIES COMPANY NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

4. ASSET ACQUISITIONS

OFFICE PROPERTIES

During January and February 2004, in accordance with the original purchase contract, the Company acquired an additional five Class A Office Properties and seven retail parcels located within Hughes Center in Las Vegas, Nevada from the Rouse Company. One of these Office Properties is owned through a joint venture in which the Company acquired a 67% interest. The remaining four Office Properties are wholly-owned by the Company. The Company acquired these five Office Properties and seven retail parcels for approximately \$175.3 million, funded by the Company's assumption of approximately \$85.4 million in mortgage loans and by a portion of the proceeds from the sale of the Company's interests in The Woodlands on December 31, 2003. The Company recorded the loans assumed at their fair value of approximately \$93.2 million, which included \$7.8 million of premium. The five Office Properties are included in the Company's Office Segment.

On March 31, 2004, the Company acquired Dupont Centre, a 250,000 square foot Class A office property, located in the John Wayne Airport submarket of Irvine, California. The Company acquired the Office Property for approximately \$54.3 million, funded by a draw on the Company's credit facility and

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subsequently placed a \$35.5 million non-recourse first mortgage loan on the property. This Office Property is wholly-owned and included in the Company's Office Segment.

On May 10, 2004, the Company completed the purchase of the remaining Hughes Center Office Property in Las Vegas, Nevada for approximately \$18.3 million. The purchase was funded by a draw on the Company's credit facility. This Office Property is wholly-owned and included in the Company's Office Segment.

On August 6, 2004, the Company acquired The Alhambra, two Class A Office Properties, located in the Coral Gables submarket of Miami, Florida. The Company acquired the Office Properties for approximately \$72.3 million, funded by the Company's assumption of a \$45.0 million loan from Wachovia Securities and a draw on the Company's credit facility. The Office Properties are wholly-owned and are included in the Company's Office Segment.

UNDEVELOPED LAND

On March 1, 2004, in accordance with the agreement to acquire the Hughes Center Properties, the Company completed the purchase of two tracts of undeveloped land in Hughes Center from the Rouse Company for \$10.0 million. The purchase was funded by a \$7.5 million loan from the Rouse Company and a draw on the Company's credit facility.

5. DISCONTINUED OPERATIONS

In accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," the results of operations of the assets sold or held for sale have been presented as "Income from discontinued operations, net of minority interests," gain or loss on the assets sold or held for sale have been presented as "Loss on real estate from discontinued operations, net of minority interests" and impairments on the assets sold or held for sale have been presented as "Impairment charges related to real estate assets from discontinued operations, net of minority interests" in the accompanying Consolidated Statements of Operations for the three and nine months ended September 30, 2004 and 2003. Minority interests for wholly-owned properties represents unitholders' share of related income, gains, losses and impairments. The carrying value of the assets held for sale has been reflected as "Properties held for disposition, net" in the accompanying Consolidated Balance Sheets as of September 30, 2004 and December 31, 2003.

ASSETS SOLD

On March 23, 2004, the Company completed the sale of the 1800 West Loop South Office Property in Houston, Texas. The sale generated proceeds, net of selling costs, of approximately \$28.2 million and a net gain of approximately \$0.2 million. The Company previously recorded an impairment charge of approximately \$13.9 million during the year ended December 31, 2003. The proceeds from the sale were used primarily to pay down the Company's credit facility. This property was wholly-owned.

On March 31, 2004, the Company sold its last remaining behavioral healthcare property. The sale generated proceeds, net of selling costs, of approximately \$2.0 million and a net loss of approximately \$0.3 million. This property was wholly-owned.

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On April 13, 2004, the Company completed the sale of the Liberty Plaza Office Property in Dallas, Texas. The sale generated proceeds, net of selling costs, of approximately \$10.8 million and a net loss of approximately \$0.2 million. The Company previously recorded an impairment charge of approximately \$3.6 million during the year ended December 31, 2003. The proceeds from the sale were used primarily to pay down the Company's credit facility. This property was wholly-owned.

On June 17, 2004, the Company completed the sale of the Ptarmigan Place Office Property in Denver, Colorado. The sale generated proceeds, net of selling costs, of approximately \$25.3 million and a net loss of approximately \$2.0 million. The Company previously recorded an impairment charge of approximately \$0.5 million during the quarter ended March 31, 2004. In addition, the Company completed the sale of approximately 3.0 acres of undeveloped land adjacent to Ptarmigan Place. The sale generated proceeds, net of selling costs, of approximately \$2.9 million and a net gain of approximately \$0.9 million. The proceeds from these sales were used to pay down a portion of the Company's Bank of America Fund XII Term Loan. The property and adjacent land were wholly-owned.

On June 29, 2004, the Company completed the sale of the Addison Tower Office Property in Dallas, Texas. The sale generated proceeds, net of selling costs, of approximately \$8.8 million and a net gain of approximately \$0.2 million. The proceeds from the sale were used primarily to pay down the Company's credit facility. This property was wholly-owned.

On July 2, 2004, the Company completed the sale of the 5050 Quorum Office Property in Dallas, Texas. The sale generated proceeds, net of selling costs, of approximately \$8.9 million and a loss of approximately \$0.1 million. The Company previously recorded an impairment charge of approximately \$0.8 million during the quarter ended March 31, 2004. The proceeds from the sale were used primarily to pay down the Company's credit facility. This property was wholly-owned. The Company continues to provide management and leasing services for this property.

On July 29, 2004, the Company completed the sale of the 12404 Park Central Office Property in Dallas, Texas. The sale generated proceeds, net of selling costs, of approximately \$9.3 million. The Company previously recorded impairment charges totaling approximately \$4.0 million, \$2.9 million during the year ended December 31, 2003, \$0.7 million during the quarter ended March 31, 2004 and \$0.4 million during the quarter ended June 30, 2004. The proceeds from the sale were used primarily to pay down the Bank of America Fund XII Term Loan. This property was wholly-owned.

On September 14, 2004, the Company completed the sale of Breckenridge Commercial Retail Center in Breckenridge, Colorado. The sale generated proceeds to the Company, net of selling costs and repayment of debt, of approximately \$1.5 million, and a net gain of approximately \$0.1 million, net of minority interests and income tax. The Company previously recorded an impairment charge of approximately \$0.7 million, net of minority interests and income tax, during the year ended December 31, 2003. The proceeds from the sale were used primarily to pay down the Company's credit facility.

ASSETS HELD FOR SALE

The following Properties are classified as held for sale as of September 30, 2004.

PROPERTY	LOCATION
-----	-----

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Hyatt Regency Albuquerque(1) Albuquerque, New Mexico
 Denver Marriott City Center Denver, Colorado

 (1) This property was sold in October 2004.

OFFICE SEGMENT

As of September 30, 2004, the Company determined that Albuquerque Plaza, in the CBD submarket in Albuquerque, New Mexico was no longer held for sale due to the Office Property no longer being actively marketed for sale as a result of changes in market conditions. The Property has been reclassified from "Properties held for disposition, net" to "Land," "Building and improvements, net of accumulated depreciation," and "Other assets, net" in the accompanying Consolidated Balance Sheets with a net book value of \$32.9 million at September 30, 2004. In addition, approximately \$2.5 million has

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CRESCENT REAL ESTATE EQUITIES COMPANY NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

been reclassified from "Income from discontinued operations, net of minority interests," to "Office Property revenue," "Interest and other income," "Office Property real estate taxes," "Office Property operating expenses" and "Depreciation and amortization" line items in the accompanying Consolidated Statements of Operations for the nine months ended September 30, 2004.

SUMMARY OF ASSETS HELD FOR SALE

The following table indicates the major asset classes of the properties held for sale.

(in thousands)	SEPTEMBER 30, 2004(1)	DECEMBER 31, 2003(2)
Land	\$ 375	\$ 13,823
Buildings and improvements	85,900	201,784
Furniture, fixtures and equipment	20,892	18,822
Accumulated depreciation	(29,131)	(52,142)
Other assets, net	31	3,848
	-----	-----
Net investment in real estate	\$ 78,067	\$ 186,135
	=====	=====

 (1) Includes two Resort/Hotel Properties and other assets.

(2) Includes six Office Properties, two Resort/Hotel Properties, one behavioral healthcare property and other assets.

The following tables present total revenues, operating and other expenses, depreciation and amortization, unitholder minority interests, impairments of real estate assets and realized loss on sale of properties for the nine months ended September 30, 2004 and 2003, for properties included in discontinued operations.

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(in thousands) -----	FOR THE NINE MONTHS ENDED SEPTEMBER 30,	
	2004 -----	2003 -----
Total revenues	\$ 41,853	\$ 62,139
Operating and other expenses	(32,691)	(40,059)
Depreciation and amortization	(1,861)	(12,587)
Unitholder minority interests	(1,109)	(1,441)
	-----	-----
Income from discontinued operations, net of minority interests	\$ 6,192	\$ 8,052
	=====	=====

(in thousands) -----	FOR THE NINE MONTHS ENDED SEPTEMBER 30,	
	2004 -----	2003 -----
Impairment charges related to real estate assets	\$ (3,201)	\$ (19,174)
Unitholder minority interests	486	2,911
	-----	-----
Impairment charges related to real estate assets from discontinued operations, net of minority interests	\$ (2,715)	\$ (16,263)
	=====	=====

(in thousands)	FOR THE NINE MONTHS ENDED SEPTEMBER 30,	
	2004 -----	2003 -----
Realized loss on sale of properties	\$ (2,537)	\$ (411)
Unitholder minority interests	385	62
	-----	-----
Loss on sale of real estate from discontinued operations, net of minority interests	\$ (2,152)	\$ (349)
	=====	=====

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CRESCENT REAL ESTATE EQUITIES COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

6. OTHER TRANSACTIONS

FOUNTAIN PLACE TRANSACTION

On June 28, 2004, the Company completed a transaction related to the Fountain Place Office Property with Crescent FP Investors, L.P., ("FP Investors"), a limited partnership that is owned 99.9% by LB FP L.L.C., an

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affiliate of Lehman Brothers Holding, Inc., (the affiliate is referred to as "Lehman"), and 0.1% by the Company. In the transaction, the Fountain Place Office Property was, for tax purposes, sold to FP Investors for \$168.2 million, including the assumption by FP Investors of a new \$90.0 million loan from Lehman Capital. The Company received net proceeds of approximately \$78.2 million. This transaction resulted in the completion of a reverse Section 1031 like-kind exchange associated with the Company's prior purchase of a portion of the Hughes Center office portfolio.

Included in the terms of this transaction is a provision which provides Lehman the unconditional right to require the Company to purchase Lehman's interest in FP Investors for an agreed upon fair value of \$79.9 million at any time until November 30, 2004. For GAAP purposes, under SFAS No. 66, "Accounting for Sales of Real Estate," this unconditional right, or contingency, results in the transaction requiring accounting associated with a financing transaction. As a result, no gain has been recorded on the transaction and the Company's accompanying financial statements continue to include the Office Property, related debt and operations until expiration of the contingency. The Company pays 99.9% of the distributable funds from the Office Property to Lehman, which is recorded in the "Interest expense" line item in the Company's Consolidated Statement of Operations. The fair value of the contingency, \$79.9 million, is included in the "Accounts payable, accrued expenses and other liabilities" line item in the Company's Consolidated Balance Sheet at September 30, 2004.

Also on June 28, 2004, the Company paid off the \$220.0 million Deutsche Bank - CMBS loan with proceeds from the Fountain Place Office Property transaction and a draw on the Company's revolving credit facility.

UNDEVELOPED LAND

On August 16, 2004, the Company sold approximately 2.5 acres of undeveloped land located in Houston, Texas. The sale generated proceeds, net of selling costs, of approximately \$6.4 million and a note receivable in the amount of \$5.6 million. The note provides for payments of principal of \$0.5 million due in December 2004, annual installments of \$1.0 million each due beginning August 2005 through August 2008, and \$1.1 million due at maturity in August 2009 and does not bear interest. The Company recognized a net gain of approximately \$7.6 million included in the "Income from investment land sales, net" line item in the accompanying Consolidated Statements of Operations. The proceeds were used to pay down the Company's credit facility.

RESIDENTIAL DEVELOPMENT

During the quarter ended September 30, 2004, the Sonoma Club was demolished in order to begin construction on a new clubhouse. Accordingly, the Company recorded an impairment charge of approximately \$2.5 million, net of income tax, included in the "Impairment charges related to real estate assets" line item in the accompanying Consolidated Statements of Operations.

CRESCENT REAL ESTATE EQUITIES COMPANY NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

7. TEMPERATURE-CONTROLLED LOGISTICS SEGMENT

TEMPERATURE-CONTROLLED LOGISTICS PROPERTIES

As of September 30, 2004, AmeriCold Logistics, LLC owned 60% by Vornado Operating L.P. and 40% by a subsidiary of Crescent Operating, Inc. ("COPI"). As sole lessee of the Temperature-Controlled Logistics Properties, AmeriCold

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Logistics leased the Temperature-Controlled Logistics Properties from the Temperature-Controlled Logistics Corporation under three triple-net master leases, as amended. The Company has an indirect 40% ownership interest in the Temperature-Controlled Logistics Corporation. The Company has no interest in COPI or AmeriCold Logistics. On March 2, 2004, the Temperature-Controlled Logistics Corporation and AmeriCold Logistics amended the leases to further extend the deferred rent period to December 31, 2005, from December 31, 2004. The parties previously extended the deferred rent period to December 31, 2004 from December 31, 2003, on March 7, 2003.

Under terms of the leases, AmeriCold Logistics elected to defer \$40.0 million of the total \$120.4 million of rent payable for the nine months ended September 30, 2004. The Company's share of the deferred rent was \$16.0 million. The Company recognizes rental income from the Temperature-Controlled Logistics Properties when earned and collected and has not recognized the \$16.0 million of deferred rent in equity in net income of the Temperature-Controlled Logistics Properties for the nine months ended September 30, 2004. As of September 30, 2004, the Temperature-Controlled Logistics Corporation's deferred rent and valuation allowance from AmeriCold Logistics were \$122.4 million and \$114.4 million, respectively, of which the Company's portions were \$49.0 million and \$45.8 million, respectively.

On February 5, 2004, the Temperature-Controlled Logistics Corporation completed a \$254.4 million mortgage financing with Morgan Stanley Mortgage Capital Inc., secured by 21 of its owned and seven of its leased temperature-controlled logistics properties. The loan matures in April 2009, bears interest at LIBOR plus 295 basis points (with a LIBOR floor of 1.5% with respect to \$54.4 million of the loan) and requires principal payments of \$5.0 million annually. The net proceeds to the Temperature-Controlled Logistics Corporation were approximately \$225.0 million, after closing costs and the repayment of approximately \$12.9 million in existing mortgages. On February 6, 2004, the Temperature-Controlled Logistics Corporation distributed cash of approximately \$90.0 million to the Company.

See Note 17, "Subsequent Events," for information regarding the purchase by the Temperature-Controlled Logistics Corporation of all the ownership interests in AmeriCold Logistics, the termination of the three triple-net master leases, and the agreement to sell an interest in the Temperature-Controlled Logistics Corporation to the Yucaipa Companies.

VORNADO CRESCENT CARTHAGE AND KC QUARRY, L.L.C.

On January 20, 2004, VCQ purchased \$6.1 million of trade receivables from Americold Logistics at a 2% discount. VCQ used cash from a \$6.0 million contribution from its owners, of which approximately \$2.4 million represented the Company's contribution for the purchase of the trade receivables. The receivables were collected during the first quarter of 2004. On March 29, 2004, VCQ purchased an additional \$4.1 million of receivables from AmeriCold Logistics at a 2% discount. VCQ used cash from collection of the trade receivables previously purchased. The remaining \$2.0 million was distributed to its owners, of which \$0.8 million was received by the Company on April 1, 2004. On July 2, 2004 and September 29, 2004, VCQ purchased an additional \$6.0 million and \$5.6 million, respectively, of receivables from AmeriCold Logistics at a 2% discount, using cash from collection of the trade receivables previously purchased.

See Note 17, "Subsequent Events," for information regarding the purchase by the Temperature-Controlled Logistics Corporation of all of the ownership interests in VCQ.

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CRESCENT REAL ESTATE EQUITIES COMPANY NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

8. INVESTMENTS IN UNCONSOLIDATED COMPANIES

The following is a summary of the Company's ownership in significant unconsolidated joint ventures and investments as of September 30, 2004.

ENTITY	CLASSIFICATION
Main Street Partners, L.P.	Office (Bank One Center-Dallas)
Crescent Miami Center, L.L.C.	Office (Miami Center - Miami)
Crescent Five Post Oak Park L.P.	Office (Five Post Oak - Houston)
Crescent One BriarLake Plaza, L.P.	Office (BriarLake Plaza - Houston)
Crescent 5 Houston Center, L.P.	Office (5 Houston Center-Houston)
Austin PT BK One Tower Office Limited Partnership	Office (Bank One Tower-Austin)
Houston PT Three Westlake Office Limited Partnership	Office (Three Westlake Park - Houston)
Houston PT Four Westlake Office Limited Partnership	Office (Four Westlake Park-Houston)
Vornado Crescent Carthage and KC Quarry, L.L.C.	Temperature-Controlled Logistics
Vornado Crescent Portland Partnership	Temperature-Controlled Logistics
Blue River Land Company, L.L.C.	Other
Canyon Ranch Las Vegas, L.L.C.	Other
EW Deer Valley, L.L.C.	Other
CR License, L.L.C.	Other
CR License II, L.L.C.	Other
SunTx Fulcrum Fund, L.P.	Other
SunTx Capital Partners, L.P.	Other
G2 Opportunity Fund, L.P. ("G2")	Other

-
- (1) The remaining 50% interest in Main Street Partners, L.P. is owned by Trizec Properties, Inc.
 - (2) The remaining 60% interest in Crescent Miami Center, L.L.C. is owned by an affiliate of a fund managed by JP Morgan Fleming Asset Management, Inc.
 - (3) The remaining 70% interest in Crescent Five Post Oak Park, L.P. is owned by an affiliate of General Electric Pension Fund Trust.
 - (4) The remaining 70% interest in Crescent One BriarLake Plaza, L.P. is owned by affiliates of JP Morgan Fleming Asset Management, Inc.
 - (5) The remaining 75% interest in Crescent 5 Houston Center, L.P. is owned by a pension fund advised by JP Morgan Fleming Asset Management, Inc.
 - (6) The remaining 80% interest in each of Austin PT BK One Tower Office Limited Partnership, Houston PT Three Westlake Office Limited Partnership and Houston PT Four Westlake Office Limited Partnership is owned by an affiliate of General Electric Pension Fund Trust.
 - (7) The remaining 44% in Vornado Crescent Carthage and KC Quarry, L.L.C. is owned by Vornado Realty Trust, L.P.
 - (8) The remaining 60% interest in Vornado Crescent Portland Partnership is

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owned by Vornado Realty Trust, L.P.

- (9) The remaining 50% interest in Blue River Land Company, L.L.C. is owned by parties unrelated to the Company. Blue River Land Company, L.L.C. was formed to acquire, develop and sell certain real estate property in Summit County, Colorado.
- (10) Of the remaining 50% interest in Canyon Ranch Las Vegas, L.L.C., 35% is owned by an affiliate of the management company of two of the Company's Resort/Hotel Properties and 15% is owned by the Company through its investment in CR License II, L.L.C. Canyon Ranch Las Vegas, L.L.C. operates a Canyon Ranch spa in a hotel in Las Vegas.
- (11) The remaining 58.3% interest in EW Deer Valley, L.L.C. is owned by parties unrelated to the Company. EW Deer Valley, L.L.C. was formed to acquire, hold and dispose of its 3.3% ownership interest in Empire Mountain Village, L.L.C. Empire Mountain Village, L.L.C. was formed to acquire, develop and sell certain real estate property at Deer Valley Ski Resort next to Park City, Utah.
- (12) The remaining 70% interest in CR License, L.L.C. is owned by an affiliate of the management company of two of the Company's Resort/Hotel Properties. CR License, L.L.C. owns the licensing agreement related to certain Canyon Ranch trade names and trademarks.
- (13) The remaining 70% interest in CR License II, L.L.C. is owned by an affiliate of the management company of two of the Company's Resort/Hotel Properties. CR License II, L.L.C. and its wholly-owned subsidiaries provide management and development consulting services to a variety of entities in the hospitality, real estate, and health and wellness industries.
- (14) Of the remaining 76.5% of SunTx Fulcrum Fund, L.P., 37.1% is owned by SunTx Capital Partners, L.P. and the remaining 39.4% is owned by a group of individuals unrelated to the Company. SunTx Fulcrum Fund, L.P.'s objective is to invest in a portfolio of acquisitions that offer the potential for substantial capital appreciation.
- (15) SunTx Capital Partners, L.P. is the general Partner of the SunTx Fulcrum Fund, L.P. The remaining 85.6% interest in SunTx Capital Partners, L.P. is owned by parties unrelated to the Company.
- (16) G2 was formed for the purpose of investing in commercial mortgage backed securities and other commercial real estate investments. The remaining 87.5% interest in G2 is owned by Goff-Moore Strategic Partners, L.P. ("GMSPLP") and by parties unrelated to the Company. G2 is managed and controlled by an entity that is owned equally by GMSPLP and GMAC Commercial Mortgage Corporation ("GMACCM"). The ownership structure of GMSPLP consists of an approximately 86% limited partnership interest owned directly and indirectly by Richard E. Rainwater, Chairman of the Board of Trust Managers of the Company, and an approximately 14% general partnership interest, of which approximately 6% is owned by Darla Moore, who is married to Mr. Rainwater, and approximately 6% is owned by John C. Goff, Vice-Chairman of the Company's Board of Trust Managers and Chief Executive Officer of the Company. The remaining approximately 2% general partnership interest is owned by unrelated parties.

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SUMMARY FINANCIAL INFORMATION

The Company reports its share of income and losses based on its ownership interest in its respective equity investments, adjusted for any preference payments. The unconsolidated entities that are included under the headings on the following tables are summarized below.

Balance Sheets as of September 30, 2004:

- Office - This includes Main Street Partners, L.P., Houston PT Three Westlake Office Limited Partnership, Houston PT Four Westlake Office Limited Partnership, Austin PT BK One Tower Office Limited Partnership, Crescent 5 Houston Center, L.P., Crescent Miami Center, L.L.C., Crescent Five Post Oak Park L.P. and Crescent One BriarLake Plaza, L.P.;
- Temperature-Controlled Logistics - This includes the Temperature-Controlled Logistics Partnership and VCQ; and
- Other - This includes Blue River Land Company, L.L.C., EW Deer Valley, L.L.C., CR License, L.L.C., CR License II, L.L.C., Canyon Ranch Las Vegas, L.L.C., SunTx Fulcrum Fund, L.P., SunTx Capital Partners, L.P. and G2.

Balance Sheets as of December 31, 2003:

- Office - This includes Main Street Partners, L.P., Houston PT Three Westlake Office Limited Partnership, Houston PT Four Westlake Office Limited Partnership, Austin PT BK One Tower Office Limited Partnership, Crescent 5 Houston Center, L.P., Crescent Miami Center, L.L.C., Crescent Five Post Oak Park L.P. and Crescent One BriarLake Plaza, L.P.;
- Temperature-Controlled Logistics - This includes the Temperature-Controlled Logistics Partnership and VCQ; and
- Other - This includes Blue River Land Company, L.L.C., EW Deer Valley, L.L.C., CR License, L.L.C., CR License II, L.L.C., Canyon Ranch Las Vegas, L.L.C., SunTx Fulcrum Fund, L.P. and G2.

Summary Statements of Operations for the nine months ended September 30, 2004:

- Office - This includes Main Street Partners, L.P., Houston PT Three Westlake Office Limited Partnership, Houston PT Four Westlake Office Limited Partnership, Austin PT BK One Tower Office Limited Partnership, Crescent 5 Houston Center, L.P., Crescent Miami Center, L.L.C., Crescent Five Post Oak Park L.P. and Crescent One BriarLake Plaza, L.P.;
- Temperature-Controlled Logistics - This includes the Temperature-Controlled Logistics Partnership and VCQ; and
- Other - This includes Blue River Land Company, L.L.C., EW Deer Valley, L.L.C., CR License, L.L.C., CR License II, L.L.C., Canyon Ranch Las Vegas, L.L.C., SunTx Fulcrum Fund, L.P., SunTx Capital Partners, L.P. and G2.

Summary Statements of Operations for the nine months ended September 30, 2003:

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- Office - This includes Main Street Partners, L.P., Houston PT Three Westlake Office Limited Partnership, Houston PT Four Westlake Office Limited Partnership, Austin PT BK One Tower Office Limited Partnership, Crescent 5 Houston Center, L.P., Crescent Miami Center, L.L.C, Crescent Five Post Oak Park L.P. and Woodlands Commercial Properties Company, L.P.;
- Temperature-Controlled Logistics - This includes the Temperature-Controlled Logistics Partnership and VCQ;
- The Woodlands Land Development Company, L.P.; and
- Other - This includes Manalapan Hotel Partners, L.L.C., Blue River Land Company, L.L.C., CR License, L.L.C., CR License II, L.L.C., the Woodlands Operating Company and Canyon Ranch Las Vegas, L.L.C., SunTx Fulcrum Fund, L.P. and G2.

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CRESCENT REAL ESTATE EQUITIES COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

BALANCE SHEETS:

AS OF SEPTEMBER 30, 2004				
(in thousands)	OFFICE	TEMPERATURE- CONTROLLED LOGISTICS	OTHER	TOTAL
Real estate, net	\$ 742,629	\$ 1,147,614		
Cash	31,473	19,378		
Other assets	63,230	114,121		
Total assets	\$ 837,332	\$ 1,281,113		
Notes payable	\$ 493,249	\$ 773,292		
Notes payable to the Company	-	-		
Other liabilities	44,448	7,014		
Equity	299,635	500,807		
Total liabilities and equity	\$ 837,332	\$ 1,281,113		
Company's share of unconsolidated debt	\$ 161,748	\$ 309,318	\$ 1,402	\$ 472,468
Company's investments in unconsolidated companies	\$ 107,671	\$ 205,971	\$ 43,308	\$ 356,950

BALANCE SHEETS:

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AS OF DECEMBER 31, 2003

(in thousands)	OFFICE	TEMPERATURE- CONTROLLED LOGISTICS	OTHER	TOTAL
Real estate, net	\$ 754,882	\$ 1,187,387		
Cash	31,309	12,439		
Other assets	51,219	88,668		
Total assets	\$ 837,410	\$ 1,288,494		
Notes payable	\$ 515,047	\$ 548,776		
Notes payable to the Company	-	-		
Other liabilities	29,746	11,084		
Equity	292,617	728,634		
Total liabilities and equity	\$ 837,410	\$ 1,288,494		
Company's share of unconsolidated debt	\$ 172,376	\$ 219,511	\$ 2,495	\$ 394,382
Company's investments in unconsolidated companies	\$ 99,139	\$ 300,917	\$ 40,538	\$ 440,594

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CRESCENT REAL ESTATE EQUITIES COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SUMMARY STATEMENTS OF OPERATIONS:

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2004

(in thousands)	OFFICE	TEMPERATURE- CONTROLLED LOGISTICS	OTHER	TOTAL
Total revenues	\$ 97,178	\$ 88,276		
Expenses:				
Operating expense	49,609	18,661 (2)		
Interest expense	22,592	38,351		
Depreciation and amortization	22,175	43,666		
Taxes and other (income) expense	113	(3,377)		
Total expenses	\$ 94,489	\$ 97,301		
Net income, impairments and gain (loss)				

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on real estate from discontinued operation	\$ 2,689	\$ (9,025)		
	=====	=====		
Company's equity in net income (loss) of unconsolidated companies	\$ 3,871	\$ (4,514)	\$ (1,728)	\$ (2,371)
	=====	=====	=====	=====

SUMMARY STATEMENTS OF OPERATIONS:

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2003

(in thousands)	OFFICE	TEMPERATURE- CONTROLLED LOGISTICS	THE WOODLANDS LAND DEVELOPMENT COMPANY, L.P. (1)	OTHER
Total revenues	\$ 107,601	\$ 90,722	\$ 82,644	
Expenses:				
Operating expense	41,934	18,322 (2)	63,950	
Interest expense	20,486	30,853	5,174	
Depreciation and amortization	24,326	43,963	5,235	
Taxes and other (income) expense	-	(1,389)	-	
Total expenses	\$ 86,746	\$ 91,749	\$ 74,359	
Gain on sale of properties	-	1,452	-	
Net income, impairments and gain (loss) on real estate from discontinued operations	\$ 20,855	\$ 425	\$ 8,285	
Company's equity in net income (loss) of unconsolidated companies	\$ 9,981	\$ 152	\$ 4,350	\$ 242

(1) The Company sold its interest in The Woodlands Land Development Company, L.P. on December 31, 2003.

(2) Inclusive of the preferred return paid to Vornado Realty Trust (1% per annum of the total combined assets).

UNCONSOLIDATED DEBT ANALYSIS

The following table shows, as of September 30, 2004, information

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about the Company's share of unconsolidated fixed and variable rate debt and does not take into account any extension options, hedge arrangements or the entities' anticipated pay-off dates.

DESCRIPTION	BALANCE OUTSTANDING AT SEPTEMBER 30, 2004	COMPANY SHARE OF BALANCE AT SEPTEMBER 30, 2004	INTEREST RATE AT SEPTEMBER 30, 2004
----- (in thousands) -----			
TEMPERATURE-CONTROLLED LOGISTICS SEGMENT:			
Vornado Crescent-Portland Partnership			
- 40% Company			
Goldman Sachs (1)	\$ 486,770	\$ 194,708	6.89%
Morgan Stanley (2)	251,457	100,583	4.71%
Various Capital Leases	35,015	14,007	4.84 to 13.63%
Bank of New York	50	20	12.88%
	-----	-----	
	773,292	309,318	
	-----	-----	
OFFICE SEGMENT:			
Main Street Partners, L.P. - 50%			
Company (3) (4) (5)	109,662	54,831	4.76%
Crescent 5 Houston Center, L.P. - 25%			
Company	90,000	22,500	5.00%
Crescent Miami Center, LLC - 40%			
Company	81,000	32,400	5.04%
Crescent One BriarLake Plaza, L.P. -			
30% Company	50,000	15,000	5.40%
Houston PT Four Westlake Office			
Limited Partnership - 20% Company	47,580	9,516	7.13%
Crescent Five Post Oak Park, L.P. -			
30% Company	45,000	13,500	4.82%
Austin PT BK One Tower Office Limited			
Partnership - 20% Company	37,007	7,401	7.13%
Houston PT Three Westlake Office			
Limited Partnership - 20% Company	33,000	6,600	5.61%
	-----	-----	
	493,249	161,748	
	-----	-----	
RESIDENTIAL SEGMENT:			
Blue River Land Company, L.L.C. - 50%			
Company (6)	2,804	1,402	4.84%
	-----	-----	
TOTAL UNCONSOLIDATED DEBT	\$ 1,269,345	\$ 472,468	
	=====	=====	
FIXED RATE/WEIGHTED AVERAGE			6.62%
VARIABLE RATE/WEIGHTED AVERAGE			4.73%

TOTAL WEIGHTED AVERAGE			5.99%
			=====

(1) URS Real Estate, L.P. and AmeriCold Real Estate, L.P., subsidiaries of the Temperature-Controlled Logistics Corporation, expect to repay this note on

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the Optional Prepayment Date of April 11, 2008. The overall weighted average maturity would be 3.6 years based on this date.

- (2) The loan bears interest at LIBOR + 295 basis points (with a LIBOR floor of 1.5% with respect to \$54.4 million of the loan) and requires principal payments of \$5.0 million annually. In connection with this loan, the Temperature-Controlled Logistics Corporation entered into an interest-rate cap agreement with a maximum LIBOR of 6.5% on the entire loan.
- (3) Senior Note - Note A: \$81.1 million at variable interest rate, LIBOR + 189 basis points, \$4.8 million at variable interest rate, LIBOR + 250 basis points with a LIBOR floor of 2.50%. Note B: \$23.8 million at variable interest rate, LIBOR + 650 basis points with a LIBOR floor of 2.50%. In connection with this loan, the Company entered into an interest-rate cap agreement with a maximum LIBOR of 4.52% on all notes. All notes are amortized based on a 25-year schedule. In August 2004, the Company contributed cash of approximately \$9.6 million to Main Street Partners, L.P. Main Street Partners, L.P. used this cash, along with an equal cash contribution from the joint venture partner, to pay off approximately \$19.1 million of the Mezzanine Note with Deutsche Bank due in December 2004. The Company and the joint venture partners have entered into an extension letter to extend the maturity to December 1, 2005.
- (4) The Company and its joint venture partner each obtained separate Letters of Credit to guarantee the repayment of up to \$4.3 million each of principal of the Main Street Partners, L.P. loan.
- (5) This facility has two one-year extension options.
- (6) The variable rate loan has an interest rate of LIBOR + 300 basis points. A fully consolidated entity of CRDI, of which CRDI owns 88.3%, provides an unconditional guarantee of up to 70% of the outstanding balance of up to a \$9.0 million loan to Blue River Land Company, L.L.C. There was approximately \$2.8 million outstanding at September 30, 2004 and the amount guaranteed was approximately \$2.0 million.

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CRESCENT REAL ESTATE EQUITIES COMPANY NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

9. NOTES PAYABLE AND BORROWINGS UNDER CREDIT FACILITY

The following is a summary of the Company's debt financing at September 30, 2004:

SECURED DEBT

AEGON Partnership Note due July 2009, bears interest at 7.53% with monthly principal and interest based on a 25-year amortization schedule, secured by the Funding III, IV and V Properties (Greenway Plaza).....

LaSalle Note I(1) due August 2027, bears interest at 7.83% with monthly principal and interest payments based on a 25-year amortization schedule, secured by the Funding I Properties.....

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Bank of America Fund XII Term Loan due January 2006, bears interest at LIBOR plus 225 basis point (at September 30, 2004, the interest rate was 3.93%), with a two-year interest-only term and a one-year interest-only option, secured by the Funding XII Properties.....

JP Morgan Mortgage Note(2) bears interest at 8.31% with monthly principal and interest payments based on a 25-year amortization schedule through maturity in October 2016, secured by the Houston Center mixed-use Property Complex

Fleet Fund I Term Loan due May 2005, bears interest at LIBOR plus 350 basis points (at September 30, 2004, the interest rate was 5.15%), with a four-year interest-only term, secured by equity interests in Fund I.....

LaSalle Note II bears interest at 7.79% with monthly principal and interest payments based on a 25-year amortization schedule through maturity in March 2006, secured by defeasance investments (3).....

Lehman Capital Note (4) due March 2005, bears interest at the 30-day LIBOR rate plus 150 basis points (at September 30, 2004, the interest rate was 3.26%), with a nine-month interest-only term, secured by the Fountain Place Office Property.....

Fleet Term Loan due February 2007, bears interest at LIBOR rate plus 450 basis points (at September 30, 2004, the interest rate was 6.21%) with an interest-only term, secured by excess cash flow distribution from Funding III, Funding IV and Funding V.....

Cigna Note due June 2010, bears interest at 5.22% with an interest-only term, secured by the 707 North Dearborn Office Property and the Denver Marriott City Center.....

Wachovia Securities(5) due November 2005, bears interest at LIBOR plus 275 basis points (at September 30, 2004, the interest rate was 4.51%) with an interest-only term, secured by the Alhambra Office Property.....

Bank of America Note due May 2013, bears interest at 5.53% with an initial 2.5-year interest-only term (through November 2005), followed by monthly principal and interest payments based on a 30-year amortization schedule, secured by The Colonnade Office Property.....

Mass Mutual Note(6) due August 2006, bears interest at 7.75% with principal and interest payments based on a 25-year amortization schedule, secured by the 3800 Hughes Parkway Office Property.....

Metropolitan Life Note V due December 2005, bears interest at 8.49% with monthly principal and interest payments based on a 25-year amortization schedule, secured by the Datran Center Office Property.....

Metropolitan Life Note VII due May 2011, bears interest at 4.31% with monthly interest-only payments based on a 25-year amortization schedule, secured by the Dupont Centre Office Property.....

CRESCENT REAL ESTATE EQUITIES COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SECURED DEBT (CONTINUED)

National Bank of Arizona Revolving Line of Credit(7) with maturities ranging from November 2004 to December 2005, bears interest at prime rate plus 0 to 100 basis points (at September 30, 2004, the interest rate was 4.75% to 5.75%) secured by certain DMDC assets.....

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Northwestern Life Note due November 2008, bears interest at 4.94% with an interest-only term, secured by 301 Congress Avenue Office Property.....

Allstate Note(6) due September 2010, bears interest at 6.65% with principal and interest payments on a 25-year amortization schedule, secured by the 3993 Hughes Parkway Office Property.....

JP Morgan Chase Note due September 2011, bears interest at 4.98% with an interest-only term, secured by 3773 Hughes Parkway Office Property.....

Metropolitan Life Note VI(6) due October 2009, bears interest at 7.71% with principal and interest payments based on a 25-year amortization schedule, secured by the 3960 Hughes Parkway Office Property.....

JP Morgan Chase Note I due September 2011, bears interest at 4.98% with an interest-only term, secured by 3753 and 3763 Hughes Parkway Office Properties.....

Northwestern Life Note II(6) due July 2007, bears interest at 7.40% with monthly principal and interest payments based on a 25-year amortization schedule, secured by the 3980 Howard Hughes Parkway Office Property.....

FHI Finance Loan bears interest at LIBOR plus 450 basis points (at September 30, 2004, the interest rate was 6.17%), with an initial interest-only term until the Net Operating Income Hurdle Date(8), followed by principal and interest payments based on a 20-year amortization schedule through maturity in September 2009, secured by the Sonoma Mission Inn & Spa

Woodmen of the World Note due April 2009, bears interest at 8.20% with an initial five-year interest-only term (through November 2006), followed by monthly principal and interest payments based on a 25-year amortization schedule, secured by the Avallon IV Office Property.....

Texas Capital Bank(9) pre-construction line of credit due July 2006, bears interest at LIBOR plus 100 basis points (at September 30, 2004, the interest rate was 4.09%) with principal and interest payments on a 25-year amortization schedule, secured by land underlying development project.....

Nomura Funding VI Note(10) due July 2020 bears interest at 10.07% with monthly principal and interest payments based on a 25-year amortization schedule, secured by the Funding VI Property.....

The Rouse Company Note due December 2005 bears interest at prime rate plus 100 basis points (at September 30, 2004, the interest rate was 5.75%) with an interest-only term, secured by undeveloped land at Hughes Center.....

Wells Fargo Note due November 2004, bears interest at LIBOR rate plus 200 basis points (at September 30, 2004, the interest rate was 3.88%) with an interest-only term, secured by 3770 Howard Hughes Parkway Office Property.....

Construction, acquisition and other obligations, bearing fixed and variable interest rates ranging from 2.9% to 10.5% at September 30, 2004, with maturities ranging between October 2004 and February 2005, secured by various CRDI and MVDC projects(11)

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2009 Notes bear interest at a fixed rate of 9.25% with a seven-year interest-only term, due April with a call date of April 2006.....

2007 Notes bear interest at a fixed rate of 7.50% with a ten-year interest-only term, due September 2007.....

Credit Facility (12) interest-only due May 2005, bears interest at LIBOR plus 212.5 basis points (at September 30, 2004, the interest rate was 3.82%).....

Total Notes Payable

-
- (1) In August 2007, the interest rate will increase, and the Company is required to remit, in addition to the monthly debt service payment, excess property cash flow, as defined, to be applied first against principal and thereafter against accrued excess interest, as defined. It is the Company's intention to repay the note in full at such time (August 2007) by making a final payment of approximately \$221.7 million.
 - (2) In October 2006, the interest rate will adjust based on current interest rates at that time. It is the Company's intention to repay the note in full at such time (October 2006) by making a final payment of approximately \$177.8 million.
 - (3) In December 2003 and January 2004, the Company purchased a total of \$179.6 million in U.S. Treasuries and government sponsored agency securities ("defeasance investments") to substitute as collateral for this loan. The cash flow from the defeasance investments (principal and interest) match the total debt service payments of this loan.
 - (4) The Company's obligations under this loan were transferred to FP Investors L.L.C. as part of the transaction in connection with the Fountain Place Office Property. See Note 6, "Other Transactions," for further information regarding this transaction.
 - (5) Includes two notes from Wachovia Securities. The notes are due November 2005, and bear interest at the LIBOR rate plus a spread of (i) 100.5 basis points for a \$31 million Wachovia note (at September 30, 2004, the interest rate was 2.765%), and (ii) 661.0 basis points for a \$14 million Wachovia note (at September 30, 2004, the interest rate was 8.37%). Both notes are secured by The Alhambra Office Property. The blended rate at September 30, 2004 for both notes was 4.51%. In October 2004, the Company refinanced this loan with a \$50.0 million loan from Morgan Stanley for a 7-year interest-only term at a fixed rate of 5.06%.
 - (6) The Company assumed these loans in connection with the Hughes Center acquisitions. The following table lists the unamortized premium associated with the assumption of above market interest rate debt which is included in the balance outstanding at September 30, 2004 and the effective interest rate of the debt including the premium.

(dollars in thousands)

Loan	Unamortized Premium	Effective Rate
Mass Mutual Note	\$ 2,648	3.47%
Allstate Note	1,522	5.19%

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Metropolitan Life Note VI	2,032	5.68%
Northwestern Life Note II	872	3.80%

Total	\$ 7,074	
	=====	

The premium was recorded as an increase in the carrying amount of the underlying debt and is being amortized as a reduction of interest expense through maturity of the underlying debt.

- (7) This facility is a \$35.6 million line of credit secured by certain DMDC land and asset improvements ("revolving credit facility"), notes receivable ("warehouse facility") and additional land ("short-term facility"). The line restricts the revolving credit facility to a maximum outstanding amount of \$24.0 million and is subject to certain borrowing base limitations and bears interest at prime (at September 30, 2004, the interest rate was 4.75%). The warehouse facility bears interest at prime plus 100 basis points (at September 30, 2004, the interest rate was 5.75%) and is limited to \$10.0 million. The short-term facility bears interest from prime plus 50 basis points to prime plus 100 basis points (at September 30, 2004, the interest rates were 5.25% to 5.75%) and is limited to \$1.6 million. The blended rate at September 30, 2004, for the revolving credit facility, the warehouse facility and the short-term facility was 5.06%.

- (8) The Company's joint venture partner, which owns a 19.9% interest in the Sonoma Mission Inn & Spa, had funded \$10.0 million of renovations at the Sonoma Mission Inn & Spa through a mezzanine loan. The Net Operating Income Hurdle Date, as defined in the loan agreement, is the date as of which the Sonoma Mission Inn & Spa has achieved an aggregate Adjusted Net Operating Income, as defined in the loan agreement, of \$12 million for a period of 12 consecutive calendar months.

- (9) This facility is a \$10.5 million pre-construction development line of credit secured by land underlying the development project located in Dallas, Texas.

- (10) In July 2010, the interest rate will adjust based on current interest rates at that time. It is the Company's intention to repay the note in full at such time (July 2010) by making a final payment of approximately \$6.1 million.

- (11) Includes \$4.3 million of fixed rate debt ranging from 2.9% to 10.5% and \$67.8 million of variable rate debt ranging from 3.87% to 5.75%.

- (12) The \$400.0 million Credit Facility with Fleet is an unsecured revolving line of credit to Funding VIII and guaranteed by the Operating Partnership. Availability under the line of credit is subject to certain covenants including limitations on total leverage, fixed charge ratio, debt service coverage, minimum tangible net worth, and specific mix of office and hotel assets and average occupancy of Office Properties. At September 30, 2004, the maximum borrowing capacity under the credit facility was \$399 million. The outstanding balance excludes letters of credit issued under the Company's credit facility of \$7.6 million which reduce the Company's maximum borrowing capacity.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

On June 28, 2004, the Company paid off the \$220.0 million Deutsche Bank-CMBS loan with proceeds from the Fountain Place transaction and a draw on the Company's credit facility. See Note 6, "Other Transactions," for additional information regarding the Fountain Place transaction. The loan was secured by the Funding X Properties and Spectrum Center. In July 2004, the Company unwound the \$220.0 million interest rate cap with JP Morgan Chase that corresponded to this loan.

The following table shows information about the Company's consolidated fixed and variable rate debt and does not include extension options, hedging arrangements or the Company's anticipated payoff dates.

(in thousands)	BALANCE	PERCENTAGE OF DEBT (1)	WEIGHTED AVERAGE RATE
Fixed Rate Debt	\$ 1,823,238	64%	7.76%
Variable Rate Debt (2)	1,032,653	36	4.30
Total Debt	\$ 2,855,891	100%	6.52% (3)

- (1) Based on contractual maturity and does not include an extension option on Bank of America Fund XII term loan or expected early payment of LaSalle Note I, J.P. Morgan Mortgage Note, or the Nomura Funding VI Note.
- (2) Balance excludes hedges. The percentages for fixed and variable rate debt, including the \$428 million of hedged variable rate debt, are 79% and 21%, respectively.
- (3) Including the effect of hedge arrangements, the overall weighted average interest rate would have been 6.78%.

Listed below are the aggregate principal payments by year required as of September 30, 2004 under indebtedness of the Company. Scheduled principal installments and amounts due at maturity are included and are based on contractual maturities and do not include extension options.

(in thousands)	SECURED DEBT	UNSECURED DEBT	UNSECURED DEBT LINE OF CREDIT	TOTAL (1)
2004	\$ 21,274	\$ -	\$ -	\$ 21,274
2005	422,277	-	307,500	729,777
2006	460,288	-	-	460,288
2007	112,193	250,000	-	362,193
2008	47,321	-	-	47,321
Thereafter	860,038	375,000	-	1,235,038
	\$ 1,923,391	\$ 625,000	\$ 307,500	\$ 2,855,891

-
- (1) Based on contractual maturity and does not include extension option on Bank of America Fund XII term loan or expected early payment of LaSalle Note I, J.P. Morgan Mortgage Note, or the Nomura Funding VI Note.

The Company is generally obligated by its debt agreements to comply with financial covenants, affirmative covenants and negative covenants, or some combination of these types of covenants. Failure to comply with covenants generally will result in an event of default under that debt instrument. Any uncured or unwaived events of default under the Company's loans can trigger an increase in interest rates, an acceleration of payment on the loan in default, and for the Company's secured debt, foreclosure on the property securing the debt. In addition, a default by the Company or any of its subsidiaries with respect to any indebtedness in excess of \$5.0 million generally will result in a default under the Credit Facility, 2007 Notes, 2009 Notes, the Bank of America Fund XII Term Loan, the Fleet Fund I Term Loan and the Fleet Term Loan after the notice and cure periods for the other indebtedness have passed. As of September 30, 2004, no event of default had occurred, and the Company was in compliance with all covenants related to its outstanding debt. The Company's debt facilities generally prohibit loan pre-payment for an initial period, allow pre-payment with a penalty during a following specified period and allow pre-payment without penalty after the expiration of that period. During the nine months ended September 30, 2004, there were no circumstances that required prepayment or increased collateral related to the Company's existing debt.

DEFEASANCE OF LASALLE NOTE II

In January 2004, the Company released the remaining properties in Funding II by reducing the Fleet Fund I and II Term Loan by \$104.2 million and purchasing an additional \$170.0 million of U.S. Treasury and government sponsored agency securities with an initial weighted average yield of 1.76%. The Company placed those securities into a collateral

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CRESCENT REAL ESTATE EQUITIES COMPANY NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

account for the sole purpose of funding payments of principal and interest on the remainder of the LaSalle Note II. The cash flow from the securities is structured to match the cash flow (principal and interest payments) required under the LaSalle Note II. The retirement of the Fleet loan and the purchase of the defeasance securities were funded through the \$275 million Bank of America Fund XII Term Loan. The collateral for the Bank of America loan was 10 of the 11 properties previously in the Funding II collateral pool. The Bank of America loan is structured to allow the Company the flexibility to sell, joint venture or long-term finance these 10 assets over the next 36 months. The final Funding II property, Liberty Plaza, was moved to the Operating Partnership and subsequently sold in April 2004.

In addition to the subsidiaries listed in Note 1, "Organization and Basis of Presentation," certain other subsidiaries of the Company were formed primarily for the purpose of obtaining secured and unsecured debt or joint venture financings. These entities, all of which are consolidated and are grouped based on the Properties to which they relate, are: Funding I Properties (CREM Holdings, LLC, Crescent Capital Funding, LLC, Crescent Funding Interest, LLC, CRE Management I Corp.); Funding III Properties (CRE Management III Corp.); Funding IV Properties (CRE Management IV Corp.); Funding V Properties (CRE

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Management V Corp.); Funding VI Properties (CRE Management VI Corp.); Funding VIII Properties (CRE Management VIII, LLC); 707 17th Street (Crescent 707 17th Street, LLC); Funding X Properties (CREF X Holdings Management, LLC, CREF X Holdings, L.P., CRE Management X, LLC); Funding XII Properties (CREF XII Parent GP, LLC, CREF XII Parent L.P., CREF XII Holding GP, LLC, CREF Holdings, L.P., CRE Management XII, LLC); Spectrum Center (Spectrum Mortgage Associates, L.P., CSC Holdings Management, LLC, Crescent SC Holdings, L.P., CSC Management, LLC), The BAC-Colonnade (CEI Colonnade Holdings, LLC), and Crescent Finance Company.

10. CASH FLOW HEDGES

The Company uses derivative financial instruments to convert a portion of its variable rate debt to fixed rate debt and to manage its fixed to variable rate debt ratio. As of September 30, 2004, the Company had three cash flow hedge agreements which are accounted for in conformity with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities - an Amendment of FASB Statement No. 133."

The following table shows information regarding the Company's interest rate swaps designated as cash flow hedge agreements during the nine months ended September 30, 2004, and additional interest expense and unrealized gains (losses) recorded in Accumulated Other Comprehensive Income ("OCI").

EFFECTIVE DATE	NOTIONAL AMOUNT	MATURITY DATE	REFERENCE RATE	FAIR MARKET VALUE	ADDITIONAL INTERE EXPENSE
-----	-----	-----	-----	-----	-----
(in thousands)					
4/18/00	\$ 100,000	4/18/04	6.76%	\$ -	\$ 1,712
2/15/03	100,000	2/15/06	3.26%	(931)	1,531
2/15/03	100,000	2/15/06	3.25%	(927)	1,529
9/02/03	200,000	9/01/06	3.72%	(3,475)	3,786
				-----	-----
				\$ (5,333)	8,558
				=====	=====

In addition, two of the Company's unconsolidated companies have cash flow hedge agreements of which the Company's portion of change in unrealized gains reflected in OCI was approximately \$0.6 million for the nine months ended September 30, 2004.

The Company has designated its cash flow hedge agreements as cash flow hedges of LIBOR-based monthly interest payments on a designated pool of variable rate LIBOR indexed debt that re-prices closest to the reset dates of each cash flow hedge agreement. The cash flow hedges have been and are expected to remain highly effective. Changes in the fair value of these highly effective hedging instruments are recorded in OCI. The effective portion that has been deferred in OCI will be reclassified to earnings as interest expense when the hedged items impact earnings. If a cash flow hedge falls outside 80%-125% effectiveness for a quarter, all changes in the fair value of the cash flow hedge for the quarter will be recognized in earnings during the current period. If it is determined based on prospective testing that it is no longer likely a hedge will be highly effective on a prospective basis, the hedge will no longer be designated as a cash flow hedge in conformity with SFAS No. 133, as amended. The Company had no ineffectiveness related to its cash flow hedges, resulting in no earnings impact due to ineffectiveness for the nine months ended September 30, 2004.

CRESCENT REAL ESTATE EQUITIES COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

INTEREST RATE CAP

In March 2004, in connection with the Bank of America Fund XII Term Loan, the Company entered into a LIBOR interest rate cap struck at 6.00% for a notional amount of approximately \$206.3 million through August 31, 2004, \$137.5 million from September 1, 2004 through February 28, 2005, and \$68.8 million from March 1, 2005 through March 1, 2006. Simultaneously, the Company sold a LIBOR interest rate cap with the same terms. Since these instruments do not reduce the Company's net interest rate risk exposure, they do not qualify as hedges and changes to their respective fair values are charged to earnings as the changes occur. As the significant terms of these arrangements are the same, the effects of a revaluation of these instruments are expected to offset each other.

11. COMMITMENTS AND CONTINGENCIES

GUARANTEE COMMITMENTS

The FASB issued Interpretation 45, "Guarantors' Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" ("FIN 45"), requiring a guarantor to disclose its guarantees. The Company's guarantees in place as of September 30, 2004 are listed in the table below. For the guarantees on indebtedness, no triggering events or conditions are anticipated to occur that would require payment under the guarantees and management believes the assets associated with the loans that are guaranteed are sufficient to cover the maximum potential amount of future payments and therefore, would not require the Company to provide additional collateral to support the guarantees. The Company has recorded a liability, in an amount not significant to its operations, for guarantees entered into following the adoption of FIN 45.

DEBTOR	GUARANTEED AMOUNT OUTSTANDING AT SEPTEMBER 30, 2004	G
		(in thousands)
CRDI - Eagle Ranch Metropolitan District - Letter of Credit (1)	\$ 7,583	\$
Blue River Land Company, L.L.C. (2) (3)	1,963	
Main Street Partners, L.P. - Letter of Credit (2) (4)	4,250	
Sovereign Bank (5)	3,654	

Total Guarantees	\$ 17,450	\$
	=====	=

(1) The Company provides a \$7.6 million letter of credit to support the payment of interest and principal of the Eagle Ranch Metropolitan District Revenue Development Bonds.

(2) See Note 8, "Investments in Unconsolidated Companies," for a description

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of the terms of this debt.

- (3) A fully consolidated entity of CRDI, of which CRDI owns 88.3%, provides an unconditional guarantee of up to 70% of the outstanding balance of up to a \$9.0 million loan to Blue River Land Company, L.L.C. There was approximately \$2.8 million outstanding at September 30, 2004 and the amount guaranteed was \$2.0 million.
- (4) The Company and its joint venture partner each obtained separate Letters of Credit to guarantee the repayment of up to \$4.3 million each of the Main Street Partners, L.P. loan.
- (5) The Company provided guarantees for the repayment of up to \$3.7 million of loans to Sovereign Bank in the event a final certificate of occupancy is not obtained for timeshare units sold at a residential development project at an entity which is consolidated into CRDI. The loans guaranteed represent third-party financing obtained by buyers of the units.

OTHER COMMITMENTS

In 2003, the Company entered into a one year option agreement for the future sale of approximately 1.5 acres of undeveloped investment land located in Houston, Texas, for approximately \$7.8 million. The Company received \$0.01 million of consideration in 2003. The option agreement may be extended up to four years on a yearly basis at the option of the prospective purchaser for additional consideration. In September 2004, the Company received \$0.01 million of consideration to extend this option for an additional year.

See Note 16, "COPI," for a description of the Company's commitments related to the agreement with COPI, executed on February 14, 2002.

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CRESCENT REAL ESTATE EQUITIES COMPANY NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

CONTINGENCIES

See Note 6, "Other Transactions," for information on the Company's \$79.9 million contingent obligation included in the "Accounts payable, accrued expenses and other liabilities" line item in the Company's Consolidated Balance Sheet at September 30, 2004, related to the Fountain Place Office Property transaction.

The Company has a contingent obligation of approximately \$1.0 million related to a construction warranty matter. The Company believes it is probable that a significant amount would be recovered through reimbursements from third parties.

12. MINORITY INTEREST

Minority interest in the Operating Partnership represents the proportionate share of the equity in the Operating Partnership of limited partners other than the Company. The ownership share of limited partners other than the Company is evidenced by Operating Partnership units. The Operating Partnership pays a regular quarterly distribution to the holders of Operating Partnership units.

Each Operating Partnership unit may be exchanged for either two common shares of the Company or, at the election of the Company, cash equal to the fair

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market value of two common shares at the time of the exchange. When a unitholder exchanges a unit, the Company's percentage interest in the Operating Partnership increases. During the nine months ended September 30, 2004, there were 9,458 units exchanged for 18,916 common shares of the Company.

Minority interest in real estate partnerships represents joint venture or preferred equity partners' proportionate share of the equity in certain real estate partnerships. The Company holds a controlling interest in the real estate partnerships and consolidates the real estate partnerships into the financial statements of the Company. Income in the real estate partnerships is allocated to minority interest based on weighted average percentage ownership during the year.

The following table summarizes the minority interest as of September 30, 2004 and December 31, 2003:

(in thousands) -----	SEPTEMBER 30, 2004 -----
Limited partners in the Operating Partnership	\$ 83,304
Development joint venture partners - Residential Development Segment	28,742
Joint venture partners - Office Segment	8,775
Joint venture partners - Resort/Hotel Segment	6,805
Other	(185)

	\$ 127,441 =====

The following table summarizes the minority interests' share of net loss (income) for the nine months ended September 30, 2004 and 2003:

(in thousands) -----	SEPTEMBER 30, 2004 -----
Limited partners in the Operating Partnership	\$ 5,721
Development joint venture partners - Residential Development Segment	(2,086)
Joint venture partners - Office Segment	96
Joint venture partners - Resort/Hotel Segment	840
Other	44

	\$ 4,615 =====

13. SHAREHOLDERS' EQUITY

DISTRIBUTIONS

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The following table summarizes the distributions paid or declared to common shareholders, unitholders and preferred shareholders during the nine months ended September 30, 2004 (dollars in thousands, except per share amounts).

SECURITY	PER SHARE DIVIDEND/ DISTRIBUTION	TOTAL AMOUNT	RECORD DATE	PAYMENT DATE	ANNUAL DIVIDEND DISTRIBUTION
Common Shares/Units (1)	\$ 0.375	\$ 43,910	01/31/04	02/13/04	\$ 1.5
Common Shares/Units (1)	\$ 0.375	\$ 43,921	04/30/04	05/14/04	\$ 1.5
Common Shares/Units (1)	\$ 0.375	\$ 43,892	07/30/04	08/13/04	\$ 1.5
Series A Preferred Shares	\$ 0.422	\$ 5,991	01/31/04	02/13/04	\$ 1.687
Series A Preferred Shares	\$ 0.422	\$ 5,991	04/30/04	05/14/04	\$ 1.687
Series A Preferred Shares	\$ 0.422	\$ 5,991	07/30/04	08/13/04	\$ 1.687
Series B Preferred Shares	\$ 0.594	\$ 2,019	01/31/04	02/13/04	\$ 2.375
Series B Preferred Shares	\$ 0.594	\$ 2,019	04/30/04	05/14/04	\$ 2.375
Series B Preferred Shares	\$ 0.594	\$ 2,019	07/30/04	08/13/04	\$ 2.375

(1) Represents one-half the amount of the distribution per unit because each unit is exchangeable for two common shares.

SERIES A PREFERRED OFFERING

On January 15, 2004, the Company completed an offering (the "January 2004 Series A Preferred Offering") of an additional 3,400,000 Series A Convertible Cumulative Preferred Shares (the "Series A Preferred Shares") at a \$21.98 per share price and with a liquidation preference of \$25.00 per share for aggregate total offering proceeds of approximately \$74.7 million. The Series A Preferred Shares are convertible at any time, in whole or in part, at the option of the holders into common shares of the Company at a conversion price of \$40.86 per common share (equivalent to a conversion rate of 0.6119 common shares per Series A Preferred Share), subject to adjustment in certain circumstances. The Series A Preferred Shares have no stated maturity and are not subject to sinking fund or mandatory redemption. At any time, the Series A Preferred Shares may be redeemed, at the Company's option, by paying \$25.00 per share plus any accumulated accrued and unpaid distributions. Dividends on the additional Series A Preferred Shares are cumulative from November 16, 2003, and are payable quarterly in arrears on the fifteenth of February, May, August and November, commencing February 16, 2004. The annual fixed dividend on the Series A Preferred Shares is \$1.6875 per share.

Net proceeds to the Company from the January 2004 Series A Preferred Offering were approximately \$71.0 million after underwriting discounts, offering costs and dividends accrued on the shares up to the issuance date. The Company used the net proceeds to pay down the Company's credit facility.

14. INCOME TAXES

TAXABLE CONSOLIDATED ENTITIES

Deferred income taxes reflect the net effects of temporary differences between the carrying amounts of assets and liabilities of taxable consolidated entities for financial reporting purposes and the amounts used for income tax purposes. For the nine months ended September 30, 2004, the taxable consolidated entities were comprised of the taxable REIT subsidiaries of the Company.

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The Company intends to maintain its qualification as a REIT under Section 856 of the U.S. Internal Revenue Code of 1986, as amended (the "Code"). As a REIT, the Company generally will not be subject to federal corporate income taxes as long as it satisfies certain technical requirements of the Code, including the requirement to distribute 90% of REIT taxable income to its shareholders. Accordingly, the Company does not believe that it will be liable for current income taxes on its REIT taxable income at the federal level or in most of the states in which it operates. The Company consolidates certain taxable REIT subsidiaries, which are subject to federal and state income tax. For the nine months ended September 30, 2004 and 2003, the Company's federal income tax benefit from continuing operations was \$13.2 million and \$10.3 million,

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CRESCENT REAL ESTATE EQUITIES COMPANY NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

respectively. The Company's \$13.2 million income tax benefit at September 30, 2004 consists primarily of \$10.4 million for the Residential Development Segment and \$5.7 million for the Resort/Hotel Segment partially offset by \$1.3 million tax expense for the Office Segment and \$1.6 million expense for other taxable REIT subsidiaries.

The Company's total net tax asset of approximately \$31.1 million at September 30, 2004 includes \$17.7 million of net deferred tax assets. SFAS No. 109, "Accounting for Income Taxes," requires a valuation allowance to reduce the deferred tax assets reported if, based on the weight of the evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized. There was no change in the valuation allowance during the nine months ended September 30, 2004.

15. RELATED PARTY TRANSACTIONS

LOANS TO EMPLOYEES AND TRUST MANAGERS OF THE COMPANY FOR EXERCISE OF STOCK OPTIONS AND UNIT OPTIONS

As of September 30, 2004, the Company had approximately \$38.0 million loan balances outstanding, inclusive of current interest accrued of approximately \$0.3 million, to certain employees and trust managers of the Company on a recourse basis pursuant to the Company's stock incentive plans and unit incentive plans pursuant to an agreement approved by the Board of Trust Managers and the Executive Compensation Committee of the Company. The proceeds of these loans were used by the employees and the trust managers to acquire common shares of the Company pursuant to the exercise of vested stock and unit options. Pursuant to the loan agreements, these loans bear interest at a rate of 2.52% per year, payable quarterly, and mature on July 28, 2012 and may be repaid in full or in part at any time without premium or penalty. Mr. Goff had a loan representing \$26.4 million of the \$38.0 million total outstanding loans at September 30, 2004. No conditions exist at September 30, 2004 which would cause any of the loans to be in default. Effective July 29, 2002, the Company ceased offering to its employees and trust managers the option to obtain loans pursuant to the Company's stock and unit incentive plans.

OTHER

On June 28, 2002, the Company purchased the home of an executive officer of the Company to facilitate the hiring and relocation of this executive officer. The purchase price was approximately \$2.6 million, consistent with a third-party appraisal obtained by the Company. Shortly after the purchase of the

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home, certain changes in the business environment in Houston resulted in a weakened housing market. In May 2004, the Company completed the sale of the home for proceeds, net of selling costs, of approximately \$1.8 million. The Company previously recorded an impairment charge of approximately \$0.6 million, net of taxes, during the year ended December 31, 2003. The purchase was part of the officer's relocation agreement with the Company.

16. COPI

On February 14, 2002, the Company and COPI entered into an agreement (the "Agreement") pursuant to which COPI and the Company agreed to jointly seek approval by the bankruptcy court of a pre-packaged bankruptcy plan for COPI. The Company agreed to fund certain of COPI's costs, claims and expenses relating to the bankruptcy and related transactions. From February 14, 2002 through September 30, 2004, the Company loaned to COPI, or paid directly on COPI's behalf, approximately \$13.2 million to fund these costs, claims and expenses, \$2.2 million of which was funded in the nine months ended September 30, 2004. The Company also agreed to issue common shares with a minimum dollar value of approximately \$2.2 million to the COPI stockholders.

In addition, the Company agreed to use commercially reasonable efforts to assist COPI in arranging COPI's repayment of its \$15.0 million obligation to Bank of America, together with any accrued interest. COPI obtained the loan from Bank of America primarily to participate in investments with the Company. As a condition to making the loan, Bank of America required Richard E. Rainwater, the Chairman of the Board of Trust Managers of the Company, and John C. Goff, Vice-Chairman of the Board of Trust Managers and Chief Executive Officer of the Company, to enter into a support agreement with COPI and Bank of America, pursuant to which Messrs. Rainwater and Goff agreed to make additional equity investments in COPI under certain circumstances. COPI has agreed that it will use the proceeds of the sale of its interest in AmeriCold Logistics to repay Bank of America in full.

On March 10, 2003, COPI filed a plan under Chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court for the Northern District of Texas. On June 22, 2004, the bankruptcy court confirmed the bankruptcy plan, as amended. Effectiveness of the pre-packaged bankruptcy plan for COPI is contingent upon a number of conditions,

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CRESCENT REAL ESTATE EQUITIES COMPANY NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

including the sale of COPI's interest in AmeriCold Logistics, the repayment of COPI's obligation to Bank of America prior to November 22, 2004 and the issuance by the Company of common shares to the COPI stockholders.

On November 4, 2004, COPI sold its interest in AmeriCold Logistics for approximately \$19.1 million. In accordance with the confirmed bankruptcy plan, COPI used approximately \$15.4 million of the proceeds to repay the loan from Bank of America, including accrued interest. In addition, in accordance with the bankruptcy plan COPI used approximately \$4.5 million of the proceeds to satisfy a portion of its debt obligations to the Company. Since the Company wrote off these debt obligations in 2001, the \$4.5 million will be included in "Interest and Other Income" in the Company's Consolidated Statement of Operations for the year ended December 31, 2004.

17. SUBSEQUENT EVENTS

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JOINT VENTURES

On November 5, 2004, the Company entered into a joint venture with affiliates of J.P. Morgan Fleming Asset Management, Inc. ("JPM") in connection with which JPM will purchase a 60% interest in three Office Properties, The Crescent, Houston Center and Post Oak Central, based on a valuation of \$898.5 million. The Company initially will hold the remaining 40% interest and anticipates a gain on the transaction.

Under this joint venture, the Company will continue to manage and lease the Office Properties on a fee basis. The Company anticipates the joint venture will be accounted for under the equity method.

TEMPERATURE-CONTROLLED LOGISTICS

On November 4, 2004, the Temperature-Controlled Logistics Corporation purchased 100% of the ownership interests in its tenant, AmeriCold Logistics, for approximately \$47.7 million. In connection with this transaction, the three triple-net master leases between the Temperature-Controlled Logistics Corporation and AmeriCold Logistics were terminated and all deferred rent was cancelled.

On November 4, 2004, the Temperature-Controlled Logistics Corporation also purchased 100% of the ownership interests in VCQ for approximately \$24.8 million. The Temperature-Controlled Logistics Corporation used cash contributions from its owners, of which the Company's 40% portion was approximately \$9.9 million, to fund the purchase. As a result of its 56% ownership interests in VCQ, the Company received proceeds from the sale of VCQ of approximately \$13.2 million.

In addition, on November 4, 2004, the Temperature-Controlled Logistics Partnership, through which the Company owns its 40% interest in the Temperature-Controlled Logistics Corporation, entered into an agreement to sell a 20.7% interest in the Temperature-Controlled Logistics Corporation to the Yucaipa Companies for \$145.0 million. In addition, Yucaipa will assist in the management of the Temperature-Controlled Logistics Corporation and may earn a promote of up to 20% of the increase in value through December 31, 2007. The promote is limited to 10% of the Temperature-Controlled Logistics Partnership's remaining common shares in the Temperature-Controlled Logistics Corporation. Immediately following this transaction, the Temperature-Controlled Logistics Partnership will dissolve and, after the payment of all of its liabilities, distribute its remaining assets to its partners. The assets to be distributed to the Company consist of common shares, representing an approximately 31.7% interest in the Temperature-Controlled Logistics Corporation and cash of approximately \$34.6 million. In addition, the partners have reached an agreement to resolve the preferential allocation.

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CRESCENT REAL ESTATE EQUITIES COMPANY NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

ASSET ACQUISITIONS

On October 21, 2004, the Company entered into a partnership agreement with affiliates of JPI Multi-family Investments L.P. to develop a single multi-family luxury apartment project in Dedham, Massachusetts. The Company funded \$13.3 million or 100% of the equity, and received a limited partnership interest which earns a preferred return and a profit split above the preferred return hurdle. The Company will consolidate the partnership, Jefferson Station, L.P., in accordance with FIN 46, as it was determined to be a VIE of which the

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Company is the primary beneficiary.

ASSET DISPOSITIONS

On October 19, 2004, the Company completed the sale of the Hyatt Regency Hotel in Albuquerque, New Mexico. The sale generated proceeds, net of selling costs, of approximately \$32.5 million and a net gain of approximately \$3.3 million, net of minority interests. This property was wholly-owned. The proceeds were used to pay down \$26.0 million of the Company's Bank of America Fund XII Term Loan and the remainder was used to pay down the Company's credit facility.

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

INDEX TO MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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FORWARD-LOOKING STATEMENTS

You should read this section in conjunction with the consolidated interim financial statements and the accompanying notes in Item 1, "Financial Statements," of this document and the more detailed information contained in the Company's Form 10-K for the year ended December 31, 2003. In management's opinion, all adjustments (consisting of normal and recurring adjustments) considered necessary for a fair presentation of the unaudited interim financial statements are included. Capitalized terms used but not otherwise defined in this section have the meanings given to them in the notes to the consolidated financial statements in Item 1, "Financial Statements."

This Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These statements are generally characterized by terms such as "believe," "expect," "anticipate" and "may."

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Although the Company believes that the expectations reflected in such forward-looking statements are based upon reasonable assumptions, the Company's actual results could differ materially from those described in the forward-looking statements.

The following factors might cause such a difference:

- The Company's ability, at its office properties, to timely lease unoccupied square footage and timely re-lease occupied square footage upon expiration on favorable terms, which continue to be adversely affected by existing real estate conditions (including vacancy rates in particular markets, decreased rental rates and competition from other properties) and may also be adversely affected by general economic downturns;
- The continuation of relatively high vacancy rates and reduced rental rates in the Company's office portfolio as a result of conditions within the Company's principal markets;
- Adverse changes in the financial condition of existing tenants, in particular El Paso Energy and its affiliates which provide 4.5% of the Company's annualized office revenues;
- Further deterioration in the resort/business-class hotel markets or in the economy generally;
- Further deterioration in the market or in the economy generally and increases in construction costs associated with development for residential land or luxury residences, including single-family homes, townhomes and condominiums;
- Financing risks, such as the Company's ability to generate revenue sufficient to service and repay existing or additional debt, increases in debt service associated with increased debt and with variable-rate debt, the Company's ability to meet financial and other covenants and the Company's ability to consummate financings and refinancings on favorable terms and within any applicable time frames;
- The ability of the Company to dispose of its investment land, and other non-core assets, on favorable terms and within anticipated time frames;
- The ability of the Company to reinvest available funds at anticipated returns and consummate anticipated office acquisitions on favorable terms and within anticipated time frames;
- The ability of the Company to close and consummate its significant pending transactions on the terms and within the time frames anticipated by management;
- The concentration of a significant percentage of the Company's assets in Texas;
- The existence of complex regulations relating to the Company's status as a REIT, the effect of future changes in REIT requirements as a result of new legislation and the adverse consequences of the failure to qualify as a REIT; and
- Other risks detailed from time to time in the Company's filings with the Securities and Exchange Commission.

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Given these uncertainties, readers are cautioned not to place undue reliance on such statements. The Company is not obligated to update these forward-looking statements to reflect any future events or circumstances.

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OVERVIEW

The Company is a REIT with assets and operations divided into four investment segments: Office, Resort/Hotel, Residential Development and Temperature-Controlled Logistics. The primary business of the Company is its Office Segment, which consisted of 75 Office Properties and represented 67% of gross assets as of September 30, 2004.

Capital flows in the real estate industry have changed significantly over the last few years. Institutions as well as other investors, principally U.S. pension funds, have increased their allocation to real estate and it appears that this will continue for the foreseeable future. This inflow of capital has created a uniquely attractive environment for the sale of assets as well as joint ventures. Likewise, the acquisition environment is highly competitive, making it more difficult to provide attractive returns on equity that are comparable to those achieved in acquisitions made during the 1990's.

The Company has adapted its strategy to align itself with institutional partners, with the goal of transitioning towards being a real estate investment management company. Rather than competing with the substantial inflow of capital into the acquisition market, the Company is focusing on acquiring assets jointly with these institutional investors, moving existing assets into joint-venture arrangements with these investors, and capitalizing on its award-winning platform in office management and its leasing expertise to continue to provide these services, for a fee, for the properties in the ventures. Where possible, the Company will strive to negotiate performance based incentives that allow for additional equity to be earned if return targets are exceeded.

Consistent with this strategy, the Company continually evaluates its existing portfolio for potential joint-venture opportunities. In the near term, the Company could more than double its existing level of joint ventures to over \$2 billion by contributing existing assets to ventures. Recently, the Company announced significant joint venture transactions involving five of its landmark Properties. The Company anticipates that these transactions, to be completed in two phases with institutional partners, will be finalized in the fourth quarter of 2004. As with previous ventures, the Company would be a minority partner but would continue to provide leasing and management services to the ventures. In addition, the Company has sold \$140 million in 2004 and expects to sell an additional \$135 million in non-core assets in the near term, including land holdings that are currently not contributing to the Company's earnings. Also included in these sales are two business class hotels, one of which was sold in October 2004 at an attractive gain and the remaining hotel, which the Company believes it can sell at an attractive gain, and at the same time further simplify its business model. As these ventures and sales are completed, the Company will redeploy proceeds into future acquisitions of traditional core assets, pay down and defease certain consolidated debt and obligations, repurchase common shares consistent with the requirements of its existing debt, and allocate capital to select operating partners.

OFFICE SEGMENT

The following table shows the performance factors used by management to assess the operating performance of the Office Segment.

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Economic Occupancy (at September 30 and December 31)
 Leased Occupancy (at September 30 and December 31)
 In-Place Weighted Average Full-Service Rental Rate (at September 30 and December 31)
 Tenant Improvement and Leasing Costs per Sq. Ft. per year (three months ended September 30)
 Tenant Improvement and Leasing Costs per Sq. Ft. per year (nine months ended September 30)
 Average Lease Term (three months ended September 30)
 Average Lease Term (nine months ended September 30)
 Same-Store NOI(3) (Decline) (three months ended September 30)
 Same-Store NOI(3) (Decline) (nine months ended September 30)
 Same-Store Average Occupancy (three months ended September 30)
 Same-Store Average Occupancy (nine months ended September 30)

-
- (1) Economic occupancy reflects the occupancy of all tenants paying rent.
 - (2) Leased occupancy reflects the amount of contractually obligated space, whether or not commencement has occurred.
 - (3) Same-store NOI (net operating income) represents office property net income excluding depreciation, amortization, interest expense and non-recurring items such as lease termination fees for Office Properties owned for the entirety of the comparable periods.

The Company continues to expect that 2004 will be a year of stabilization in the Office Segment rather than meaningful growth, with projected average and year end occupancy remaining relatively flat compared to 2003. Tenant improvement and leasing costs in 2004 are expected to be in line with 2003. Same-store NOI is expected to decline by 3% to 6% in 2004, which is a lower rate of decline than that experienced in 2003.

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RESORTS

The following table shows the performance factors used by management to assess the operating performance of the Resort Properties.

	FOR THE THREE MONTHS ENDED SEPT			
	AVERAGE OCCUPANCY RATE		AVERAGE DAILY RATE	
	2004	2003	2004	2003
Luxury and Destination Fitness Resorts	80%	76%	\$ 436	\$ 406

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FOR THE NINE MONTHS ENDED SEPTEMBER 30,

	AVERAGE OCCUPANCY RATE		AVERAGE DAILY RATE	
	2004	2003	2004	2003
Luxury and Destination Fitness Resorts	71%	72%	\$ 490	\$ 460

The occupancy decrease at the Company's luxury and destination fitness resorts for the nine months ended September 30, 2004 as compared to the same period in 2003 is partially driven by a seven percentage point decrease in occupancy at Sonoma Mission Inn (from 66% to 59%) as a result of the renovation of 97 rooms which were taken out of service in November 2003. Renovation was completed in the second quarter of 2004 and the 97 rooms were put back into service. In addition, occupancy decreased thirteen percentage points (from 77% in the third quarter 2003 to 64% in the third quarter 2004) at Ventana Inn as a result of the renovation of 13 suites which were taken out of service in April 2004.

The luxury and destination fitness resorts occupancy, average daily rate, and revenue per available room increases in the third quarter 2004 compared to third quarter 2003 were driven primarily by increases at Canyon Ranch Tucson and Canyon Ranch Lenox at which occupancy increased seven percentage points (from 77% to 84%), average daily rate increased 6% (from \$620 to \$658), and revenue per available room increased 12% (from \$448 to \$503) as a result of expanded medical service offerings.

The Company anticipates a minimal change in occupancy and a modest increase in revenue per available room in 2004 at the Resort Properties as the economy and the travel industry continue to recover, offset by the financial impact of Sonoma Mission Inn and Ventana Inn renovations in 2004.

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RESIDENTIAL DEVELOPMENT SEGMENT

The following tables show the performance factors used by management to assess the operating performance of the Residential Development Segment. Information is provided for the Desert Mountain Residential Development Property and the CRDI Residential Development Properties, which represent the Company's significant investments in this Segment as of September 30, 2004.

Desert Mountain

	FOR THE THREE MONTHS ENDED SEPTEMBER 30,	
	2004	2003
Residential Lot Sales	5	10
Average Sales Price per Lot (1)	\$923,000	\$457,000

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(1) Includes equity golf membership

	FOR THE NINE MONTHS ENDED SEPTEMBER 30,	
	2004	2003
Residential Lot Sales	44	34
Average Sales Price per Lot (1)	\$807,000	\$611,000

(1) Includes equity golf membership

Desert Mountain is in the latter stages of development and has primarily its premier lots remaining in inventory. An increase in lot sales, combined with higher average sales prices in 2004 compared to 2003, is expected to result in improved results in 2004.

CRDI

	FOR THE THREE MONTHS	
	2004	
Residential Lot Sales	31	
Residential Unit Sales	9	
Residential Timeshare Units	3.9	
Average Sales Price per Residential Lot	\$200,000	
Average Sales Price per Residential Unit	\$1,901,000	
Average Sales Price per Residential Equivalent Timeshare Unit	\$2,262,000	

	FOR THE NINE MONTHS	
	2004	
Residential Lot Sales	150	
Residential Unit Sales	20	
Residential Timeshare Units	7.32	
Average Sales Price per Residential Lot	\$137,000	
Average Sales Price per Residential Unit	\$1,413,000	
Average Sales Price per Residential Equivalent Timeshare Unit	\$2,151,000	

CRDI, which invests primarily in mountain resort residential real estate in Colorado and California and residential real estate in downtown Denver, Colorado, is highly dependent upon the national economy and customer demand. In 2004, management expects that CRDI will be primarily affected by product mix available at its Residential Development Properties as product inventory is developed in 2004 for delivery in 2005.

LIQUIDITY

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The Company's primary sources of liquidity are cash flow from operations, its credit facility, return of capital from the Residential Development Segment, and proceeds from asset sales and joint ventures. The Company believes cash flows from operations will be sufficient to offset normal operating expenses, as well as capital requirements (including property improvements, tenant improvements and leasing commissions) in 2004. The cash flow from the Residential Development segment is cyclical in nature and primarily realized in the last quarter of each year. The Company expects to meet any interim shortfalls in operating cash flow caused by this cyclical nature through working capital draws under the credit facility. As of September 30, 2004, the Company had \$83.9 million in borrowing capacity remaining under its credit facility. However, net cash flows from operations are not anticipated to fully cover the projected dividends on the Company's common stock. The Company expects to use cash

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from operations as well as return of capital from the Residential Development Segment, estimated at approximately \$85 million for 2004, proceeds from asset sales and joint ventures and business initiatives including investment land sales and other income to cover the shortfall.

Through the sale of the Woodlands in December 2003, the issuance of preferred shares and additional financing of Temperature-Controlled Logistics this year, and additional leverage on Hughes Center assets, the Company has in excess of \$200 million in liquidity to make new investments throughout 2004, of which \$90.5 million has been invested through September 30, 2004 and \$64.6 million has been used to pay down debt until reinvestment opportunities arise. Additionally, the Company continues to execute on its capital recycling program and has sold six office properties and one business class hotel generating proceeds, net of selling costs, of \$126.7 million which were used to pay down a portion of the Bank of America Fund XII Term Loan and to reduce the amount outstanding under the credit facility.

RECENT DEVELOPMENTS

JOINT VENTURES

On November 5, 2004, the Company entered into a joint venture with affiliates of J.P. Morgan Fleming Asset Management, Inc. ("JPM") in connection with which JPM will purchase a 60% interest in three Office Properties, The Crescent, Houston Center and Post Oak Central, based on a valuation of \$898.5 million. The Company initially will hold the remaining 40% interest and is currently in negotiations with another institutional investor, for a transaction that would reduce its interest to 24%. In addition, the Company is in final negotiations with JPM to form a second joint venture in which JPM will purchase a 76% interest in two Office Properties, Trammell Crow Center and Fountain Place. The Company anticipates a gain on these transactions.

Under both joint ventures, the Company will continue to manage and lease the Office Properties on a fee basis. The Company anticipates the joint ventures will be accounted for under the equity method.

TEMPERATURE-CONTROLLED LOGISTICS

On November 4, 2004, the Temperature-Controlled Logistics Corporation purchased 100% of the ownership interests in its tenant, AmeriCold Logistics, for approximately \$47.7 million. In connection with this transaction, the three triple-net master leases between the Temperature-Controlled Logistics Corporation and AmeriCold Logistics were terminated and all deferred rent was cancelled.

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On November 4, 2004, the Temperature-Controlled Logistics Corporation also purchased 100% of the ownership interests in VCQ for approximately \$24.8 million. The Temperature-Controlled Logistics Corporation used cash contributions from its owners, of which the Company's 40% portion was approximately \$9.9 million, to fund the purchase. As a result of its 56% ownership interests in VCQ, the Company received proceeds from the sale of VCQ of approximately \$13.2 million.

In addition, on November 4, 2004, the Temperature-Controlled Logistics Partnership, through which the Company owns its 40% interest in the Temperature-Controlled Logistics Corporation, entered into an agreement to sell a 20.7% interest in the Temperature-Controlled Logistics Corporation to the Yucaipa Companies for \$145.0 million. In addition, Yucaipa will assist in the management of the Temperature-Controlled Logistics Corporation and may earn a promote of up to 20% of the increase in value through December 31, 2007. The promote is limited to 10% of the Temperature-Controlled Logistics Partnership's remaining common shares in the Temperature-Controlled Logistics Corporation. Immediately following this transaction, the Temperature-Controlled Logistics Partnership will dissolve and, after the payment of all of its liabilities, distribute its remaining assets to its partners. The assets to be distributed to the Company consist of common shares, representing an approximately 31.7% interest in the Temperature-Controlled Logistics Corporation and cash of approximately \$34.6 million. In addition, the partners have reached an agreement to resolve the preferential allocation.

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ASSET ACQUISITIONS

OFFICE

During January and February 2004, in accordance with the original purchase contract, the Company acquired an additional five Class A Office Properties and seven retail parcels located within Hughes Center in Las Vegas, Nevada from the Rouse Company. One of these Office Properties is owned through a joint venture in which the Company acquired a 67% interest. The remaining four Office Properties are wholly-owned by the Company. The Company acquired these five Office Properties and seven retail parcels for approximately \$175.3 million, funded by the Company's assumption of approximately \$85.4 million in mortgage loans and by a portion of the proceeds from the sale of the Company's interests in The Woodlands on December 31, 2003. The Company recorded the loans assumed at their fair value of approximately \$93.2 million, which included \$7.8 million of premium. The five Office Properties are included in the Company's Office Segment.

On March 31, 2004, the Company acquired Dupont Centre, a 250,000 square foot Class A office property, located in the John Wayne Airport submarket of Irvine, California. The Company acquired the Office Property for approximately \$54.3 million, funded by a draw on the Company's credit facility and subsequently placed a \$35.5 million non-recourse first mortgage loan on the property. This Office Property is wholly-owned and included in the Company's Office Segment.

On May 10, 2004, the Company completed the purchase of the remaining Hughes Center Office Property in Las Vegas, Nevada for approximately \$18.3 million. The purchase was funded by a draw on the Company's credit facility. This Office Property is wholly-owned and included in the Company's Office Segment.

On August 6, 2004, the Company acquired The Alhambra, two Class A Office

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Properties, located in the Coral Gables submarket of Miami, Florida. The Company acquired the Office Properties for approximately \$72.3 million, funded by the Company's assumption of a \$45.0 million loan from Wachovia Securities and a draw on the Company's credit facility. The Office Properties are wholly-owned and are included in the Company's Office Segment.

UNDEVELOPED LAND

On March 1, 2004, in accordance with the agreement to acquire the Hughes Center Properties, the Company completed the purchase of two tracts of undeveloped land in Hughes Center from the Rouse Company for \$10.0 million. The purchase was funded by a \$7.5 million loan from the Rouse Company and a draw on the Company's credit facility.

RESIDENTIAL DEVELOPMENT

On October 21, 2004, the Company entered into a partnership agreement with affiliates of JPI Multi-family Investments, L.P. to develop a single multi-family luxury apartment project in Dedham, Massachusetts. The Company funded \$13.3 million or 100% of the equity, and received a limited partnership interest which earns a preferred return and a profit split above the preferred return hurdle. The Company will consolidate the partnership, Jefferson Station, L.P., in accordance with FIN 46, as it was determined to be a VIE of which the Company is the primary beneficiary.

ASSET DISPOSITIONS

OFFICE

On March 23, 2004, the Company completed the sale of the 1800 West Loop South Office Property in Houston, Texas. The sale generated proceeds, net of selling costs, of approximately \$28.2 million and a net gain of approximately \$0.2 million, net of minority interests. The Company previously recorded an impairment charge of approximately \$13.9 million, net of minority interests, during the year ended December 31, 2003. The proceeds from the sale were used primarily to pay down the Company's credit facility. This property was wholly-owned.

On March 31, 2004, the Company sold its last remaining behavioral healthcare property. The sale generated proceeds, net of selling costs, of approximately \$2.0 million and a net loss of approximately \$0.3 million, net of minority interests. This property was wholly-owned.

On April 13, 2004, the Company completed the sale of the Liberty Plaza Office Property in Dallas, Texas. The sale generated proceeds, net of selling costs, of approximately \$10.8 million and a net loss of approximately \$0.2 million, net of minority interests. The Company previously recorded an impairment charge of approximately \$3.6 million, net of minority interests, during the year ended December 31, 2003. The proceeds from the sale were used primarily to pay down the Company's credit facility. This property was wholly-owned.

On June 17, 2004, the Company completed the sale of the Ptarmigan Place Office Property in Denver, Colorado. The sale generated proceeds, net of selling costs, of approximately \$25.3 million and a net loss of approximately \$2.0 million, net of minority interests. The Company previously recorded an impairment charge of approximately \$0.5 million, net of minority interests, during the quarter ended March 31, 2004. In addition, the Company completed the sale of approximately 3.0 acres of undeveloped land adjacent to Ptarmigan Place. The sale generated proceeds, net of selling costs, of approximately \$2.9 million

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and a net gain of approximately \$0.9 million. The proceeds from these sales were used to pay down a portion of the Company's Bank of America Fund XII Term Loan. The property and adjacent land were wholly-owned.

On June 29, 2004, the Company completed the sale of the Addison Tower Office Property in Dallas, Texas. The sale generated proceeds, net of selling costs, of approximately \$8.8 million and a net gain of approximately \$0.2 million, net of minority interests. The proceeds from the sale were used primarily to pay down the Company's credit facility. This property was wholly-owned.

On July 2, 2004, the Company completed the sale of the 5050 Quorum Office Property in Dallas, Texas. The sale generated proceeds, net of selling costs, of approximately \$8.9 million and a loss of approximately \$0.1 million, net of minority interests. The Company previously recorded an impairment charge of approximately \$0.8 million, net of minority interests, during the quarter ended March 31, 2004. The proceeds from the sale were used primarily to pay down the Company's credit facility. This property was wholly-owned. The Company continues to provide management and leasing services for this property.

On July 29, 2004, the Company completed the sale of the 12404 Park Central Office Property in Dallas, Texas. The sale generated proceeds, net of selling costs, of approximately \$9.3 million. The Company previously recorded impairment charges totaling approximately \$4.0 million, net of minority interests, \$2.9 million during the year ended December 31, 2003, \$0.7 million during the quarter ended March 31, 2004 and \$0.4 million during the quarter ended June 30, 2004. The proceeds from the sale were used primarily to pay down the Bank of America Fund XII Term Loan. This property was wholly-owned.

UNDEVELOPED LAND

On August 16, 2004, the Company sold approximately 2.5 acres of undeveloped land located in Houston, Texas. The sale generated proceeds, net of selling costs, of approximately \$6.4 million and a note receivable in the amount of \$5.6 million. The note provides for payments of principal of \$0.5 million due in December 2004, annual installments of \$1.0 million each due beginning August 2005 through August 2008, and \$1.1 million due at maturity in August 2009 and does not bear interest. The Company recognized a net gain of approximately \$7.6 million included in the "Income from investment land sales, net" line item in the accompanying Consolidated Statements of Operations. The proceeds were used to pay down the Company's credit facility.

RESORT/HOTEL

On October 19, 2004, the Company completed the sale of the Hyatt Regency Hotel in Albuquerque, New Mexico. The sale generated proceeds, net of selling costs, of approximately \$32.5 million and a net gain of approximately \$3.3 million, net of minority interests. This property was wholly-owned. The proceeds were used to pay down \$26.0 million of the Company's Bank of America Fund XII Term Loan and the remainder was used to pay down the Company's credit facility.

RESIDENTIAL DEVELOPMENT

On September 14, 2004, the Company completed the sale of Breckenridge Commercial Retail Center in Breckenridge, Colorado. The sale generated proceeds to the Company, net of selling costs and repayment of debt, of approximately \$1.5 million, and a net gain of approximately \$0.1 million, net of minority interests and income tax. The Company previously recorded an impairment charge of approximately \$0.7 million, net of minority interests and income tax, during the year ended December 31, 2003. The proceeds from the sale were used primarily to pay down the Company's credit facility.

OTHER TRANSACTIONS

FOUNTAIN PLACE TRANSACTION

On June 28, 2004, the Company completed a transaction related to the Fountain Place Office Property with Crescent FP Investors, L.P., ("FP Investors"), a limited partnership that is owned 99.9% by LB FP L.L.C., an affiliate of Lehman Brothers Holding, Inc., (the affiliate is referred to as "Lehman"), and 0.1% by the Company. In the transaction, the Fountain Place Office Property was, for tax purposes, sold to FP Investors for \$168.2 million, including the assumption by FP Investors of a new \$90.0 million loan from Lehman Capital. The Company received net proceeds of approximately \$78.2 million. This transaction resulted in the completion of a reverse Section 1031 like-kind exchange associated with the Company's prior purchase of a portion of the Hughes Center office portfolio.

Included in the terms of this transaction is a provision which provides Lehman the unconditional right to require the Company to purchase Lehman's interest in FP Investors for an agreed upon fair value of \$79.9 million at any time until November 30, 2004. For GAAP purposes, under SFAS No. 66, "Accounting for Sales of Real Estate," this unconditional right, or contingency, results in the transaction requiring accounting associated with a financing transaction. As a result, no gain has been recorded on the transaction and the Company's accompanying financial statements continue to include the Office Property, related debt and operations until expiration of the contingency. The Company pays 99.9% of the distributable funds from the Office Property to Lehman, which is recorded in the "Interest expense" line item in the Company's Consolidated Statement of Operations. The fair value of the contingency, \$79.9 million, is included in the "Accounts payable, accrued expenses and other liabilities" line item in the Company's Consolidated Balance Sheet at September 30, 2004.

Also on June 28, 2004, the Company paid off the \$220.0 million Deutsche Bank - CMBS loan with proceeds from the Fountain Place Office Property transaction and a draw on the Company's revolving credit facility.

See "Recent Developments" for a description of the joint venture transaction involving this Office Property. As a result of this transaction, Lehman's unconditional right to require the Company to repurchase Lehman's interest in FP Investors will be terminated.

RESULTS OF OPERATIONS

The following table shows the Company's variance in dollars between the three and nine months ended September 30, 2004 and 2003.

(in millions)	TOTAL VARIANCE IN DOLLARS BETWEEN THE THREE MONTHS ENDED SEPTEMBER 30, ----- 2004 AND 2003 -----
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REVENUE:	
Office Property	\$ 5.2
Resort/Hotel Property	4.7
Residential Development Property	25.6

TOTAL PROPERTY REVENUE	\$ 35.5

EXPENSE:	
Office Property real estate taxes	\$ 0.4
Office Property operating expenses	3.7
Resort/Hotel Property expense	4.1
Residential Development Property expense	19.5

TOTAL PROPERTY EXPENSE	27.7

INCOME FROM PROPERTY OPERATIONS	\$ 7.8

OTHER INCOME (EXPENSE):	
Income from investment land sales, net	\$ (3.8)
Gain on joint venture of properties, net	-
Interest and other income	1.3
Corporate general and administrative	(1.7)
Interest expense	(3.5)
Amortization of deferred financing costs	(0.7)
Extinguishment of debt	(0.2)
Depreciation and amortization	(10.1)
Impairment charges related to real estate assets	(4.1)
Other expenses	-
Equity in net income (loss) of unconsolidated companies:	
Office Properties	(4.6)
Resort/Hotel Properties	0.1
Residential Development Properties	(2.5)
Temperature-Controlled Logistics Properties	-
Other	1.1

TOTAL OTHER INCOME (EXPENSE)	\$ (28.7)

LOSS FROM CONTINUING OPERATIONS BEFORE MINORITY INTERESTS AND INCOME TAXES	\$ (20.9)

Minority interests	1.9
Income tax benefit	1.7

LOSS BEFORE DISCONTINUED OPERATIONS AND CUMULATIVE EFFECT OF A CHANGE IN ACCOUNTING PRINCIPLE	\$ (17.3)

Income from discontinued operations, net of minority interests	1.6
Impairment charges related to real estate assets from discontinued operations, net of minority interests	1.7
Loss on real estate from discontinued operations, net of minority interests	-
Cumulative effect of a change in accounting principle	-

NET (LOSS) INCOME	\$ (14.0)

Series A Preferred Share distributions	(1.4)

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Series B Preferred Share distributions

-

NET LOSS AVAILABLE TO COMMON SHAREHOLDERS

\$ (15.4)
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COMPARISON OF THE THREE MONTHS ENDED SEPTEMBER 30, 2004 TO THE THREE MONTHS ENDED SEPTEMBER 30, 2003

PROPERTY REVENUES

Total property revenues increased \$35.5 million, or 17.7%, to \$235.9 million for the three months ended September 30, 2004, as compared to \$200.4 million for the three months ended September 30, 2003. The primary components of the increase in total property revenues are discussed below.

- Office Property revenues increased \$5.2 million, or 4.2%, to \$128.3 million, primarily due to:
 - an increase of \$13.9 million from the acquisitions of The Colonnade in August 2003, the Hughes Center Properties in December 2003 through May 2004, the Dupont Centre in March 2004 and The Alhambra in August 2004; and
 - an increase of \$0.6 million primarily resulting from third party management and leasing services and related direct expense reimbursements; partially offset by
 - a decrease of \$5.8 million from the 55 consolidated Office Properties (excluding 2003 and 2004 acquisitions and dispositions) that the Company owned or had an interest in, primarily due to a decrease in full service weighted average rental rates, a decrease in recoveries due to expense reductions, and a decline in net parking revenue, partially offset by a 0.2 percentage point increase in same-store average occupancy (from 85.7% to 85.9%); and
 - a decrease of \$3.7 million in net lease termination fees (from \$5.0 million to \$1.3 million).
- Resort/Hotel Property revenues increased \$4.7 million, or 11.1%, to \$47.0 million, primarily due to:
 - an increase of \$3.0 million at the Destination Fitness Resorts related to a 12.3% increase in revenue per available room (from \$448 to \$503) as a result of a 6.1% increase in average daily rate (from \$620 to \$658) and a 7 percentage point increase in occupancy (from 77% to 84%); and
 - an increase of \$1.7 million at the Resort Properties related to a 6.2% increase in revenue per available room (room \$177 to \$188) as a result of a 6.0% increase in average daily rate (from \$234 to \$248) and a \$1.1 million increase in food and beverage revenue.
- Residential Development Property revenues increased \$25.6 million, or 73.1%, to \$60.6 million, primarily due to:

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- an increase of \$21.5 million in CRDI revenues related to product mix in lots and units available for sale in 2004 versus 2003, primarily at the Old Greenwood project in Tahoe, California and the Horizon Pass project in Bachelor Gulch, Colorado which had sales in 2004, but none in the three months ended September 30, 2003 as the projects were not available for sale, partially offset by the One Vendue project in Charleston, South Carolina which had sales in 2003, but none in 2004 as the project sold out in 2003;
- an increase of \$2.7 million in other revenue at DMDC due to a settlement for reimbursement of construction remediation costs;
- an increase of \$1.7 million in club revenue at CRDI primarily due to the addition of a restaurant, and the full impact in 2004 of the sale of Tahoe Club memberships at the Tahoe Mountain Resorts Property, which began selling memberships in mid-2003; and
- an increase of \$0.5 million in club revenue at DMDC and CRDI primarily due to increased membership levels; partially offset by
- a decrease of \$0.7 million in real estate sales primarily due to decreased home sales at DMDC.

PROPERTY EXPENSES

Total property expenses increased \$27.7 million, or 21.5%, to \$156.4 million for the three months ended September 30, 2004, as compared to \$128.7 million for the three months ended September 30, 2003. The primary components of the variances in property expenses are discussed below.

- Office Property expenses increased \$4.1 million, or 7.0%, to \$62.4 million, primarily due to:
 - an increase of \$5.0 million from the acquisition of The Colonnade in August 2003, the Hughes Center Properties in December 2003 through May 2004, the Dupont Centre in March 2004 and The Alhambra in August 2004; and
 - an increase of \$0.8 million related to the cost of providing third party management and leasing services; partially offset by

- a decrease of \$1.7 million from the 55 consolidated Office Properties (excluding 2003 and 2004 acquisitions and dispositions) that the Company owned or had an interest in, primarily due to:
 - \$2.0 million decrease in building repairs and maintenance;
 - \$1.2 million decrease in property taxes and insurance; and

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- \$0.4 million decrease in utilities expense; partially offset by
- \$1.4 million increase in administrative expenses.
- Resort/Hotel Property expenses increased \$4.1 million, or 11.6%, to \$39.5 million, due to:
 - an increase of \$2.3 million in operating expenses and general and administrative costs at the Destination Fitness Resorts primarily related to increased employee health insurance costs and increased average occupancy of 7 percentage points (from 77% to 84%); and
 - an increase of \$1.7 million in operating expenses at the Resort Properties related to food, beverage and marketing costs.
- Residential Development Property expenses increased \$19.5 million, or 55.7%, to \$54.5 million, primarily due to:
 - an increase of \$15.6 million in CRDI cost of sales related to product mix in lots and units available for sale in 2004 versus 2003, primarily at the Old Greenwood project in Tahoe, California and the Horizon Pass project in Bachelor Gulch, Colorado which had sales in 2004, but none in the three months ended September 30, 2003 as the projects were not available for sale, partially offset by the One Vendue project in Charleston, South Carolina which had sales in 2003, but none in 2004 as the project sold out in 2003;
 - an increase of \$3.4 million in club operating expenses due to increased membership levels, a restaurant addition at CRDI and the golf course addition at DMDC; and
 - an increase of \$0.5 million in expenses related to marketing efforts at the Ritz-Carlton condominium residence project.

OTHER INCOME/EXPENSE

Total other expenses increased \$28.7 million, or 40.7%, to \$99.2 million for the three months ended September 30, 2004, compared to \$70.5 million for the three months ended September 30, 2003. The primary components of the increase in total other expenses are discussed below.

OTHER INCOME

Other income decreased \$8.4 million, or 46.2%, to \$9.8 million for the three months ended September 30, 2004, as compared to \$18.2 million for the three months ended September 30, 2003. The primary components of the decrease in other income are discussed below.

- Equity in net income of unconsolidated companies decreased \$5.9 million, or 105.4%, to a \$0.3 million loss, primarily due to:
 - a decrease of \$6.1 million in Office, Residential Development and Other equity in net income primarily due to net income recorded in 2003 for the Company's interests in the entities through which the Company held its interests in The Woodlands, which were sold in December 2003;

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- Income from investment land sales, net decreased \$3.8 million due to the gain on sale of two parcels of undeveloped investment land in Texas in 2003, offset by the gain on sale of two parcels of undeveloped investment land in Texas, in 2004.
- Interest and other income increased \$1.3 million primarily due to \$0.7 million of interest on U.S. Treasury and government sponsored agency securities purchased in December 2003 and January 2004 related to debt defeasance, \$0.4 million of dividends received on other marketable securities and a \$0.3 million increase in interest on certain notes resulting from note amendments in December 2003.

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OTHER EXPENSES

Other expenses increased \$20.3 million, or 22.9%, to \$108.9 million for the three months ended September 30, 2004, as compared to \$88.6 million for the three months ended September 30, 2003. The primary components of the increase in other expenses are discussed below.

- Depreciation expense increased \$10.1 million, or 28.4 %, to \$45.7 million, primarily due to:
 - \$8.3 million increase in Office Property depreciation expense, attributable to:
 - \$6.4 million from the acquisitions of The Colonnade in August 2003 and the Hughes Center Properties in December 2003 through May 2004, the Dupont Centre in March 2004 and The Alhambra in August 2004; and
 - \$1.9 million due to an increase in leasehold improvements, lease commissions, building improvements, and accelerated depreciation of leasehold improvements and lease commissions upon lease terminations;
 - \$1.1 million increase in Resort/Hotel Property depreciation expense; and
 - \$1.0 million increase in Residential Development Property depreciation expense.
- Impairment charges increased \$4.1 million due to the impairment related to the demolition of the old clubhouse at the Sonoma Club in the third quarter 2004 in order to construct a new clubhouse.
- Interest expense increased \$3.5 million, or 8.1%, to \$46.5 million primarily due to the Fountain Place Office Property transaction.
- Corporate general and administrative expense increased \$1.7 million, or 23.3%, to \$9.0 million primarily due to salary merit increases, cost increases of employee benefits, restricted stock compensation recorded in 2004, and Sarbanes-Oxley related costs.

DISCONTINUED OPERATIONS

Income from discontinued operations on assets sold and held for sale increased \$3.3 million, or 194.1%, to \$1.6 million, primarily due to:

- an increase of \$2.0 million, net of minority interests, due to

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impairments recorded in 2003 on behavioral healthcare properties; and

- an increase of \$1.5 million, net of minority interests, due to the increase in net income associated with properties held for sale in 2004 compared to 2003.

COMPARISON OF THE NINE MONTHS ENDED SEPTEMBER 30, 2004 TO THE NINE MONTHS ENDED SEPTEMBER 30, 2003

PROPERTY REVENUES

Total property revenues increased \$48.0 million, or 7.5%, to \$685.6 million for the nine months ended September 30, 2004, as compared to \$637.6 million for the nine months ended September 30, 2003. The primary components of the increase in total property revenues are discussed below.

- Office Property revenues increased \$20.4 million, or 5.6 %, to \$384.6 million, primarily due to:
 - an increase of \$34.7 million from the acquisitions of The Colonnade in August 2003, the Hughes Center Properties in December 2003 through May 2004, the Dupont Centre in March 2004 and The Alhambra in August 2004;
 - an increase of \$2.0 million primarily resulting from third party management and leasing services and related direct expense reimbursements; and
 - an increase of \$0.6 million in net lease termination fees (from \$7.9 million to \$8.5 million); partially offset by
 - a decrease of \$15.8 million from the 55 consolidated Office Properties (excluding 2003 and 2004 acquisitions and dispositions) that the Company owned or had an interest in, primarily due to a decrease in full service weighted average rental rates, a decrease in recoveries due to expense reductions, and a decline in net parking revenues, partially offset by a 0.2 percentage point increase in same-store average occupancy (from 85.6% to 85.8%); and
 - a decrease of \$1.1 million due to nonrecurring revenue earned in 2003.

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- Resort/Hotel Property revenues increased \$4.4 million, or 3.3%, to \$137.2 million, primarily due to:
 - an increase of \$6.3 million at the Destination Fitness Resorts related to a 9.1% increase in revenue per available room (from \$481 to \$525) as a result of a 7.2% increase in average daily rate (from \$642 to \$688) and a 3 percentage point increase in occupancy (from 79% to 82%); partially offset by
 - a decrease of \$1.1 million at the Resort Properties related to 5.9% decrease in revenue per available room (room \$185 to \$174) as a result of a 4 percentage point decrease in occupancy (from 65% to 61%); and
 - a decrease of \$0.8 million at the Business Class Hotel Properties related to a 6.5% decrease in revenue per available room (from \$77 to \$72) as a result of a 3 percentage point decrease in

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occupancy (from 69% to 66%).

- Residential Development Property revenues increased \$23.2 million, or 16.5%, to \$163.9 million, primarily due to:
 - an increase of \$17.0 million primarily due to increased sales of 10 lots (from 34 to 44) at DMDC;
 - an increase of \$3.0 million in club revenue at CRDI primarily due to the addition of a restaurant and the full impact in 2004 of the sale of Tahoe Club memberships at the Tahoe Mountain Resorts Property, which began selling memberships in mid-2003;
 - an increase of \$2.7 million in club revenue at DMDC primarily due to increased membership levels; and
 - an increase of \$2.7 million in other revenue at DMDC due to a settlement for reimbursement of construction remediation costs; partially offset by
 - a decrease of \$1.2 million in CRDI cost of sales related to product mix in lots and units available for sale in 2004 versus 2003, primarily at the One Vendue project in Charleston, South Carolina which had sales in 2003, but none in 2004 as the project sold out in 2003, partially offset by the Old Greenwood project in Tahoe, California and the Horizon Pass project in Bachelor Gulch, Colorado which had sales in 2004, but none in the nine months ended September 30, 2003 as the projects were not available for sale; and
 - a decrease of \$1.2 million in other revenue due to interest income recorded in 2003 on a note receivable from the Woodlands Land Development Company, L.P., entity which was sold in December 2003.

PROPERTY EXPENSES

Total property expenses increased \$28.3 million, or 6.8%, to \$444.8 million for the nine months ended September 30, 2004, as compared to \$416.5 million for the nine months ended September 30, 2003. The primary components of the variances in property expenses are discussed below.

- Office Property expenses increased \$6.8 million, or 3.9%, to \$182.6 million, primarily due to:
 - an increase of \$11.6 million from the acquisition of The Colonnade in August 2003, the Hughes Center Properties in December 2003 through May 2004, the Dupont Centre in March 2004, and The Alhambra in August 2004; and
 - an increase of \$1.5 million related to the cost of providing third party management and leasing services to joint venture properties; partially offset by
 - a decrease of \$5.7 million from the 55 consolidated Office Properties (excluding 2003 and 2004 acquisitions and dispositions) that the Company owned or had an interest in, primarily due to:
 - \$4.2 million decrease in building repairs and maintenance;
 - \$4.2 million decrease in property taxes and insurance; and

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- \$0.6 million decrease in utilities; partially offset by
- \$2.0 million increase in administrative expenses;
- Resort/Hotel Property expenses increased \$6.7 million, or 6.2%, to \$115.4 million, primarily due to:
 - an increase of \$5.8 million in operating expenses and general and administrative costs at the Destination Fitness Resorts primarily related to increased employee health insurance costs and increased average occupancy of 3 percentage points (from 79% to 82%); and
 - an increase of \$1.1 million in resort property food and beverage operating expense and marketing costs.

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- Residential Development Property expenses increased \$14.8 million, or 11.2%, to \$146.8 million, primarily due to:
 - an increase of \$8.7 million in DMDC cost of sales due to increased lot sales compared to 2003 (from 34 to 44);
 - an increase of \$6.9 million in club operating expenses due to increased membership levels at CRDI and DMDC, a restaurant addition at CRDI and the golf course addition at DMDC;
 - an increase of \$5.0 million in marketing expenses at certain CRDI projects and the Ritz Carlton condominium residence project; and
 - an increase of \$0.6 million in other expense categories; partially offset by
 - a decrease of \$6.4 million in CRDI cost of sales related to product mix in lots and units available for sale in 2004 versus 2003, primarily at the One Vendue project in Charleston, South Carolina which had sales in 2003, but none in 2004 as the project sold out in 2003, partially offset by the Old Greenwood project in Tahoe, California and the Horizon Pass project in Bachelor Gulch, Colorado which had sales in 2004, but none in the nine months ended September 30, 2003 as the projects were not available for sale.

OTHER INCOME/EXPENSE

Total other expenses increased \$59.4 million, or 25.7%, to \$290.6 million for the nine months ended September 30, 2004, compared to \$231.2 million for the nine months ended September 30, 2003. The primary components of the increase in total other expenses are discussed below.

OTHER INCOME

Other income decreased \$17.3 million, or 54.6%, to \$14.4 million for the nine months ended September 30, 2004, as compared to \$31.7 million for the nine months ended September 30, 2003. The primary components of the decrease in other income are discussed below.

- Equity in net income of unconsolidated companies decreased \$17.1 million, or 116.3%, to a \$2.4 million loss, primarily due to:

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- a decrease of \$10.1 million equity in Office, Residential Development and Other net income, primarily due to net income recorded in 2003 for the Company's interests in the entities through which the Company held its interests in The Woodlands, which were sold in December 2003;
 - a decrease of \$4.7 million in Temperature-Controlled Logistics Properties equity in net income primarily due to a decrease in rental revenues net of deferred rent and an increase in interest expense primarily attributable to the \$254.4 million financing with Morgan Stanley Mortgage Capital, Inc. in February 2004; and
 - a decrease of \$2.3 million in Resort/Hotel Properties equity in net income primarily due to net income recorded in 2003 for the Company's interest in the Ritz-Carlton Hotel Property which was sold in November 2003 and included a \$1.1 million payment which the Company received from the operator of the Resort/Hotel Property pursuant to the terms of the operating agreement because the Property did not achieve the specified net operating income level.
- Income from investment land sales, net decreased \$4.4 million due to the gains on sales of three parcels of undeveloped investment land in Texas in 2003, offset by the gains on sales of three parcels of undeveloped investment land in Texas, in 2004.
 - Interest and other income increased \$4.3 million primarily due to \$2.2 million of interest on U.S. Treasury and government sponsored agency securities purchased in December 2003 and January 2004 related to debt defeasance, \$0.9 million of dividends received on other marketable securities and a \$0.8 million increase in interest on certain notes resulting from note amendments in December 2003.

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OTHER EXPENSES

Other expenses increased \$42.1 million, or 16.0%, to \$305.0 million for the nine months ended September 30, 2004, as compared to \$262.9 million for the nine months ended September 30, 2003. The primary components of the increase in other expenses are discussed below.

- Depreciation expense increased \$22.9 million, or 21.9%, to \$127.7 million, primarily due to:
 - \$18.1 million increase in Office Property depreciation expense, attributable to:
 - \$12.3 million from the acquisitions of The Colonnade in August 2003 and the Hughes Center Properties in December 2003 through May 2004, the Dupont Centre in March 2004 and The Alhambra in August 2004; and
 - \$5.8 million due to an increase in leasehold improvements, lease commissions, building improvements, and accelerated depreciation of leasehold improvements and lease commissions upon lease terminations;
 - \$3.0 million increase in Residential Development Property depreciation expense; and

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- \$2.3 million increase in Resort/Hotel Property depreciation expense.
- Interest expense increased \$7.7 million, or 6.0%, to \$137.0 million, primarily due to:
 - \$3.7 million increase from an increase of approximately \$312 million in the weighted average debt balance, partially offset by a .58 percentage point decrease in the weighted average interest rate (from 7.19% to 6.61%) primarily due to the refinancing and new financings of fixed rate debt at lower interest rates and the termination of a \$400 million cash flow hedge, which were replaced with \$400 million of cash flow hedges resulting in a 3.1 percentage point reduction in strike prices (from 6.6% to 3.5%); and
 - \$3.2 million increase related to the Fountain Place Office Property transaction.
- Corporate general and administrative expense increased \$3.8 million, or 20.1%, to \$22.7 million primarily due to salary merit increases, cost increases of employee benefits, restricted stock compensation recorded in 2004 and Sarbanes-Oxley related costs.
- Extinguishment of debt increased \$3.1 million primarily due to the write off of deferred financing costs associated with the following:
 - reduction of the Fleet Fund I and II Term Loan in January 2004;
 - the write off of deferred financing costs associated with reduction of the Bank of America Fund XII Term Loan funded by proceeds from the sale of Ptarmigan Place Office Property and adjacent land and the 12404 Park Central Office Property; and
 - the write off of deferred financing costs associated with the payoff of the \$220.0 million Deutsche Bank-CMBS Loan in June 2004 funded with proceeds from the Fountain Place Office Property transaction and a draw on the credit facility.
- Impairment charges increased \$2.9 million primarily due to the \$4.1 million impairment related to the demolition of the old clubhouse at the Sonoma Club in the third quarter 2004 in order to construct a new clubhouse, partially offset by a \$1.2 million impairment of the North Dallas Athletic Club in the first quarter 2003.
- Amortization of deferred financing costs increased \$2.5 million, or 32.5%, to \$10.2 million primarily due to the addition of deferred financing costs related to debt restructuring and refinancing associated with the \$275.0 million secured loan with Bank of America and Deutsche Bank in January 2004.

DISCONTINUED OPERATIONS

Income from discontinued operations on assets sold and held for sale increased \$9.8 million, or 114.0%, to income of \$1.3 million, primarily due to:

- an increase of \$12.8 million, net of minority interests, due to the impairment of the 1800 West Loop South Office Property in 2003; and
- an increase of \$3.5 million, net of minority interests, impairments recorded in 2003 on the behavioral healthcare properties; partially

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offset by

- a decrease of \$2.4 million, net of minority interests, due to the impairment of three Office Properties in 2004;
- a decrease of \$1.9 million, net of minority interests, due to the reduction of net income associated with properties held for sale in 2004 compared to 2003; and
- a decrease of \$2.0 million, net of minority interests, due to an aggregate loss on six Office Properties sold in 2004.

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LIQUIDITY AND CAPITAL RESOURCES

CASH FLOWS

(in millions)	FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2004

Cash provided by Operating Activities	\$ 75.3
Cash used in Investing Activities	(221.9)
Cash provided by Financing Activities	133.1

Decrease in Cash and Cash Equivalents	\$ (13.5)
Cash and Cash Equivalents, Beginning of Period	78.0

Cash and Cash Equivalents, End of Period	\$ 64.5
	=====

OPERATING ACTIVITIES

The Company's cash provided by operating activities of \$75.3 million is attributable to Property operations.

INVESTING ACTIVITIES

The Company's cash used in investing activities of \$221.9 million is primarily attributable to:

- \$195.8 million purchase of U.S. Treasuries and government sponsored agency securities in connection with the defeasance of LaSalle Note II and other securities;
- \$193.3 million for the acquisition of investment properties, primarily due to the acquisition of Hughes Center, the Dupont Centre and The Alhambra Office Properties;
- \$68.1 million for revenue and non-revenue enhancing tenant improvement and leasing costs for Office Properties;
- \$31.3 million for property improvements for rental properties, primarily attributable to non-recoverable building improvements for the Office Properties, renovations at Sonoma Mission Inn and Ventana Inn, and replacement of furniture, fixtures and equipment for the Resort/Hotel Properties;

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- \$28.3 million for development of amenities at the Residential Development Properties;
- \$10.1 million of additional investment in unconsolidated Office Properties primarily due to a \$9.6 million contribution to Main Street Partners L.P.;
- \$3.8 million for development of investment properties;
- \$2.6 million of additional investment in unconsolidated Other companies;
- \$2.4 million of additional investment in unconsolidated Temperature-Controlled Logistics Properties; and
- \$1.0 million of additional investment in unconsolidated Residential Development Properties.

The cash used in investing activities is partially offset by:

- \$113.9 million of proceeds from property sales, primarily due to the sale of the 1800 West Loop South, Liberty Plaza, Ptarmigan Place, Addison Tower, 5050 Quorum and 12404 Park Central Office Properties;
- \$92.3 million decrease in restricted cash, due primarily to decreased escrow deposits for the purchase of the Hughes Center Office Properties in January and February 2004;
- \$90.8 million from return of investment in Temperature-Controlled Logistics Properties due primarily to the \$254.4 million of additional financing at the Temperature-Controlled Logistics Corporation;
- \$8.8 million of proceeds from defeasance investment maturities;
- \$4.8 million decrease in notes receivable;
- \$2.3 million from return of investment in unconsolidated Office Properties; and
- \$1.3 million from return of investment in unconsolidated Resort/Hotel Properties.

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FINANCING ACTIVITIES

The Company's cash provided by financing activities of \$133.1 million is primarily attributable to:

- \$454.6 million of proceeds from other borrowings, primarily as a result of the Bank of America Fund XII Term Loan secured by the Fund XII Properties, the Lehman Capital Note secured by the Fountain Place Office Property, the Metropolitan Life Note VII secured by the Dupont Centre Office Property, and the new JP Morgan Chase Notes secured by certain Hughes Center Properties;
- \$440.0 million of proceeds from borrowings under the Company's credit facility;
- \$79.9 million of proceeds from the Fountain Place Office Property

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transaction;

- \$77.7 million of proceeds from borrowings for construction costs for infrastructure development at the Residential Development Properties;
- \$71.0 million of net proceeds from issuance of Series A Preferred Shares;
- \$2.1 million of capital contributions from joint venture partners; and
- \$0.4 million of net proceeds from the exercise of share options.

The cash provided by financing activities is partially offset by:

- \$386.6 million of payments under other borrowings, due primarily to the pay off of the Deutsche Bank-CMBS Loan, the pay down of the Fleet Fund I Term Loan and the pay down of the Bank of America Fund XII Term Loan;
- \$371.5 million of payments under the Company's credit facility;
- \$131.7 million of distributions to common shareholders and unitholders;
- \$62.5 million of Residential Development Property note payments;
- \$24.0 million of distributions to preferred shareholders;
- \$8.2 million of debt financing costs primarily associated with the \$275 million Bank of America Fund XII Term Loan and the Lehman Capital Note;
- \$6.3 million of capital distributions to joint venture partners; and
- \$1.8 million of amortization of debt premiums.

LIQUIDITY REQUIREMENTS

DEBT FINANCING SUMMARY

The following tables show summary information about the Company's debt, including its share of unconsolidated debt as of September 30, 2004. Additional information about the significant terms of the Company's debt financing arrangements and its unconsolidated debt is contained in Note 9, "Notes Payable and Borrowings under Credit Facility" and Note 8, "Investments in Unconsolidated Companies," of Item 1, "Financial Statements."

AS OF SEPTEMBER 30, 2004

(in thousands)	TOTAL COMPANY DEBT	SHARE OF UNCONSOLIDATED DEBT	TOTAL
	-----	-----	-----
Fixed Rate Debt	\$ 1,823,238	\$ 315,652	\$2,138,890
Variable Rate Debt	1,032,653	156,816	1,189,469
	-----	-----	-----
Total Debt	\$ 2,855,891	\$ 472,468	\$3,328,359
	=====	=====	=====

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Listed below are the aggregate principal payments by year required as of September 30, 2004. Scheduled principal installments and amounts due at maturity are included.

(in thousands)	SECURED DEBT	UNSECURED DEBT	UNSECURED DEBT LINE OF CREDIT	TOTAL COMPANY DEBT	SHARE OF UNCONSOLIDATED DEBT
2004	\$ 21,274	\$ -	\$ -	\$ 21,274	\$ 58,
2005	422,277	-	307,500	729,777	8,
2006	460,288	-	-	460,288	25,
2007	112,193	250,000	-	362,193	48,
2008	47,321	-	-	47,321	44,
Thereafter	860,038	375,000	-	1,235,038	287,
	<u>\$ 1,923,391</u>	<u>\$ 625,000</u>	<u>\$ 307,500</u>	<u>\$ 2,855,891</u>	<u>\$ 472,</u>

(1) Based on contractual maturity and does not include extension option on Bank of America Fund XII term loan or expected early payment of LaSalle Note I, JP Morgan Mortgage Note, or the Nomura Funding VI Note.

OFF-BALANCE SHEET ARRANGEMENTS - GUARANTEE COMMITMENTS

The FASB issued Interpretation 45, "Guarantors' Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others," requiring a guarantor to disclose its guarantees. The Company's guarantees in place as of September 30, 2004 are listed in the table below. For the guarantees on indebtedness, no triggering events or conditions are anticipated to occur that would require payment under the guarantees and management believes the assets associated with the loans that are guaranteed are sufficient to cover the maximum potential amount of future payments and therefore, would not require the Company to provide additional collateral to support the guarantees. The Company has recorded a liability, in an amount not significant to its operations, for guarantees entered into following the adoption of FIN 45.

DEBTOR	GUARANTEED AMOUNT OUTSTANDING AT SEPTEMBER 30, 2004	MAXIMUM GUARANTEE AMOUNT
	(in thousands)	
CRDI - Eagle Ranch Metropolitan District - Letter of Credit (1)	\$ 7,583	\$ 7,
Blue River Land Company, L.L.C. (2) (3)	1,963	6,
Main Street Partners, L.P. - Letter of Credit (2) (4)	4,250	4,
Sovereign Bank (5)	3,654	3,
Total Guarantees	\$ 17,450	\$21,

=====

-
- (1) The Company provides a \$7.6 million letter of credit to support the payment of interest and principal of the Eagle Ranch Metropolitan District Revenue Development Bonds.
 - (2) See Note 8, "Investments in Unconsolidated Companies," for a description of the terms of this debt.
 - (3) A fully consolidated entity of CRDI, of which CRDI owns 88.3%, provides a guarantee of 70% of the outstanding balance of up to a \$9.0 million loan to Blue River Land Company, L.L.C. There was approximately \$2.8 million outstanding at September 30, 2004 and the amount guaranteed was \$2.0 million.
 - (4) The Company and its joint venture partner each provide separate Letters of Credit to guarantee repayment of up to \$4.3 million each of the Main Street Partners, L.P. loan.
 - (5) The Company provided guarantees for the repayment of up to \$3.7 million of loans from Sovereign Bank in the event a final certificate of occupancy is not obtained for timeshare units sold at a residential development project at an entity which is consolidated into CRDI. The loans guaranteed represent third-party financing obtained by buyers of the units.

OTHER COMMITMENTS AND CONTINGENCIES

See "Recent Developments" in this Item 2, for information on the Company's \$79.9 million contingent obligation related to the Fountain Place Office Property transaction.

The Company has a contingent obligation of approximately \$1.0 million related to a construction warranty matter. The Company believes it is probable that a significant amount would be recovered through reimbursements from third parties.

CAPITAL EXPENDITURES

As of September 30, 2004, the Company had unfunded capital expenditures of approximately \$26.1 million relating to capital investments that are not in the ordinary course of operations of the Company's business segments. The table below specifies the Company's requirements for capital expenditures and its amounts funded as of September 30, 2004, and amounts remaining to be funded (future fundings classified between short-term and long-term capital requirements):

(in millions)

PROJECT	TOTAL PROJECT COST (1)	AMOUNT FUNDED AS OF SEPTEMBER 30, 2004	AMOUNT REMAINING TO FUND
-----	-----	-----	-----

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OFFICE SEGMENT			
Acquired Properties (3)	\$ 2.9	\$ 2.7	\$ 0.2
Houston Center Shops Redevelopment (4)	11.6	10.9	0.7
RESIDENTIAL DEVELOPMENT SEGMENT			
Tahoe Mountain Club(5)	54.3	50.6	3.7
RESORT/HOTEL SEGMENT			
Canyon Ranch - Tucson Land - Construction Loan (6)	2.4	1.0	1.4
OTHER			
SunTx (7)	19.0	14.3	4.7
Purchase of AmeriCold Logistics (formerly "Crescent Spinco") (8)	15.4	-	15.4
TOTAL	----- \$105.6 =====	----- \$79.5 =====	----- \$ 26.1 =====

- (1) All amounts are approximate.
- (2) Reflects the Company's estimate of the breakdown between short-term and long-term capital expenditures.
- (3) The capital expenditures reflect the Company's ownership percentage of 30% for Five Post Oak Park Office Property.
- (4) Located within the Houston Center Office Property complex.
- (5) As of September 30, 2004, the Company had invested \$50.6 million in Tahoe Mountain Club, which includes the acquisition of land and development of a golf course and retail amenities. During 2004, the Company is developing a swim and fitness facility, clubhouse, and completing the golf course.
- (6) The Company has a \$2.4 million construction loan with the purchaser of the land, which will be secured by nine developed lots and a \$0.4 million letter of credit.
- (7) This commitment is related to the Company's investment in a private equity fund and its general partner. The commitment is based on cash contributions and distributions and does not consider equity gains or losses.
- (8) On November 4, 2004 COPI sold its interests in AmeriCold Logistics and paid off the \$15.4 million, inclusive of accrued interest, loan to Bank of America. As a result, the Company has no further capital expenditure requirements with respect to the COPI bankruptcy.

In April 2004, the Company entered into agreements with Ritz-Carlton Hotel Company, L.L.C. to develop the first Ritz-Carlton hotel and condominium project in Dallas, Texas with development to commence upon reaching an acceptable level of pre-sales for the residences. The development plans include a Ritz-Carlton with approximately 216 hotel rooms and 70 residences. Construction on the development is anticipated to begin in the second quarter of 2005.

LIQUIDITY OUTLOOK

The Company expects to fund its short-term capital requirements of approximately \$22.9 million through a combination of net cash flow from

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operations and borrowings under the Company's credit facility or additional debt facilities. As of September 30, 2004, the Company had maturing debt obligations of \$610.6 million through September 30, 2005, consisting primarily of its credit facility, Fleet Fund I Term Loan and the Lehman Capital Note. The Company plans to refinance the credit facility and the Fleet Fund I Term Loan in 2004. The Lehman Capital Note is also expected to be refinanced. The remaining maturities consist primarily of normal principal amortization and will be met with cash flow from operations. In addition, \$26.0 million of debt relating to the Residential Developments is maturing within the next 12 months and will be retired with the sales of the corresponding land or units or will be refinanced.

The Company expects to meet its other short-term liquidity requirements, consisting of normal recurring operating expenses, principal and interest payment requirements, non-revenue enhancing capital expenditures and revenue enhancing capital expenditures (such as property improvements, tenant improvements and leasing costs), and distributions to shareholders and unitholders, primarily through cash flow provided by operating activities. The Company expects to fund the remainder of these short-term liquidity requirements with borrowings under the

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Company's credit facility, return of capital from Residential Development Properties, proceeds from the sale of non-core investments, other business initiatives or the joint venture of Properties, and borrowings under additional debt facilities.

The Company's long-term liquidity requirements as of September 30, 2004 consist primarily of \$2.2 billion of debt maturing after September 30, 2005. The Company also has \$3.2 million of long-term capital expenditures requirements. The Company anticipates meeting these long-term maturity obligations primarily through refinancing maturing debt with long-term secured and unsecured debt and through other debt and equity financing alternatives as well as cash proceeds received from the sale or joint venture of Properties.

Debt and equity financing alternatives currently available to the Company to satisfy its liquidity requirements and commitments for material capital expenditures include:

- Additional proceeds from the Company's Credit Facility under which the Company had up to \$83.9 million of borrowing capacity available as of September 30, 2004;
- Additional proceeds from the refinancing of existing secured and unsecured debt;
- Additional debt secured by existing underleveraged properties;
- Issuance of additional unsecured debt; and
- Equity offerings including preferred and/or convertible securities or joint ventures of existing properties.

The following factors could limit the Company's ability to utilize these financing alternatives:

- The reduction in the operating results of the Properties supporting the Company's Credit Facility to a level that would reduce the availability of funds under the Credit Facility;
- A reduction in the operating results of the Properties could limit the Company's ability to refinance existing secured and unsecured debt, or

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extend maturity dates or could result in an uncured or unwaived event of default;

- The Company may be unable to obtain debt or equity financing on favorable terms, or at all, as a result of the financial condition of the Company or market conditions at the time the Company seeks additional financing;
- Restrictions under the Company's debt instruments or outstanding equity may prohibit it from incurring debt or issuing equity on terms available under then-prevailing market conditions or at all; and
- The Company may be unable to service additional or replacement debt due to increases in interest rates or a decline in the Company's operating performance.

The Company's portion of unconsolidated debt maturing through September 2005 is \$64.5 million. The Company's portion of unconsolidated debt maturing after September 2005 is \$408.0 million. Unconsolidated debt is the liability of the unconsolidated entity, is typically secured by that entity's property, and is non-recourse to the Company except where a guarantee exists.

EQUITY AND DEBT FINANCING

SERIES A PREFERRED OFFERING

On January 15, 2004, the Company completed an offering (the "January 2004 Series A Preferred Offering") of an additional 3,400,000 Series A Convertible Cumulative Preferred Shares (the "Series A Preferred Shares") at a \$21.98 per share price and with a liquidation preference of \$25.00 per share for aggregate total offering proceeds of approximately \$74.7 million. The Series A Preferred Shares are convertible at any time, in whole or in part, at the option of the holders, into common shares of the Company at a conversion price of \$40.86 per common share (equivalent to a conversion rate of 0.6119 common shares per Series A Preferred Share), subject to adjustment in certain circumstances. The Series A Preferred Shares have no stated maturity and are not subject to sinking fund or mandatory redemption. At any time, the Series A Preferred Shares may be redeemed, at the Company's option, by paying \$25.00 per share plus any accumulated accrued and unpaid distributions. Dividends on the additional Series A Preferred Shares are cumulative from November 16, 2003, and are payable quarterly in arrears on the fifteenth of February, May, August and November, commencing February 16, 2004. The annual fixed dividend on the Series A Preferred Shares is \$1.6875 per share.

Net proceeds to the Company from the January 2004 Series A Preferred Offering were approximately \$71.0 million after underwriting discounts, offering costs and dividends accrued on the shares up to the issuance date. The Company used the net proceeds to pay down the Company's credit facility.

SHARE REPURCHASE PROGRAM

The Company commenced its Share Repurchase Program in March 2000. On October 15, 2001, the Company's Board of Trust Managers increased from \$500.0 million to \$800.0 million the amount of outstanding common shares that can be repurchased from time to time in the open market or through privately negotiated transactions (the "Share Repurchase Program"). There were no share repurchases under the program for the year ended December 31, 2003 or the nine months ended September 30, 2004. As of September 30, 2004, the Company had repurchased 20,256,423 common shares under the Share Repurchase Program, at an aggregate cost of approximately \$386.9 million, resulting in an average repurchase price of \$19.10 per common share. All repurchased shares were recorded as treasury shares.

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DEBT FINANCING ARRANGEMENTS

The significant terms of the Company's primary debt financing arrangements existing as of September 30, 2004, are shown below:

DESCRIPTION (1)	MAXIMUM BORROWINGS	BALANCE OUTSTANDING AT SEPTEMBER 30, 2004
(dollars in thousands)		
SECURED FIXED RATE DEBT:		
AEGON Partnership Note (Greenway Plaza)	\$ 256,017	\$ 256,017
LaSalle Note I (Fund I)	232,673	232,673
JP Morgan Mortgage Note (Houston Center)	187,922	187,922
LaSalle Note II (Fund II Defeasance) (2)	158,030	158,030
Cigna Note (707 17th Street/Denver Marriott)	70,000	70,000
Bank of America Note (Colonnade)	38,000	38,000
Mass Mutual Note (3800 Hughes) (3)	37,315	37,315
Metropolitan Life Note V (Datran Center)	37,006	37,006
Metropolitan Life Note VII (Dupont Centre)	35,500	35,500
Northwestern Life Note (301 Congress)	26,000	26,000
Allstate Note (3993 Hughes) (3)	25,687	25,687
JP Morgan Chase (3773 Hughes)	24,755	24,755
Metropolitan Life Note VI (3960 Hughes) (3)	24,142	24,142
JP Morgan Chase I (3753/3763 Hughes)	14,350	14,350
Northwestern Life II (3980 Hughes) (3)	10,310	10,310
Woodmen of the World Note (Avallon IV)	8,500	8,500
Nomura Funding VI Note (Canyon Ranch - Lenox)	7,709	7,709
Construction, Acquisition and other obligations for various CRDI and Mira Vista projects	4,322	4,322
Subtotal/Weighted Average	\$ 1,198,238	\$ 1,198,238
UNSECURED FIXED RATE DEBT:		
The 2009 Notes	\$ 375,000	\$ 375,000
The 2007 Notes	250,000	250,000
Subtotal/Weighted Average	\$ 625,000	\$ 625,000
SECURED VARIABLE RATE DEBT:		
Bank of America Fund XII Term Loan (Fund XII) (4)	\$ 226,035	\$ 226,035
Fleet Fund I Term Loan (Fund I)	160,000	160,000
Lehman Capital Note (Fountain Place)	90,000	90,000
Fleet Term Loan (Distributions from Fund III, IV and V)	75,000	75,000
Wachovia Securities (Alhambra) (5)	45,000	45,000
National Bank of Arizona (Desert Mountain)	35,580	31,041
FHI Finance Loan (Sonoma Mission Inn)	10,000	10,000
Texas Capital Bank (Land)	10,500	7,977
The Rouse Company (Hughes Center undeveloped land)	7,500	7,500

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Wells Fargo Bank (3770 Hughes)	4,774	4,774
Construction, Acquisition and other obligations for various CRDI and Mira Vista projects	180,248	67,826
	-----	-----
Subtotal/Weighted Average	\$ 844,637	\$ 725,153
	-----	-----
UNSECURED VARIABLE RATE DEBT:		
Credit Facility	\$ 399,000	\$ 307,500 (6)
	-----	-----
Subtotal/Weighted Average	\$ 399,000	\$ 307,500
	-----	-----
TOTAL/WEIGHTED AVERAGE	\$ 3,066,875	\$ 2,855,891
	=====	=====

AVERAGE REMAINING TERM

- (1) For more information regarding the terms of the Company's debt financing arrangements, including properties securing the Company's secured debt and the method of calculation of the interest rate for the Company's variable rate debt, see Note 9, "Notes Payable and Borrowings under the Credit Facility," included in Item 1, "Financial Statements."
- (2) In December 2003, the Company defeased approximately \$8.7 million of this loan to release one of the Funding II Properties securing the loan by purchasing \$9.6 million in U.S. Treasuries and government sponsored agency securities to substitute as collateral. On January 15, 2004, the Company defeased approximately \$150.7 million to release the remainder of the Funding II properties by purchasing \$170.0 million in U.S. Treasuries and government sponsored agency securities. The earnings and principal maturity from these investments will pay the principal and interest associated with the LaSalle Note II.
- (3) Includes a portion of total premiums of \$7.1 million reflecting market value of debt acquired with purchase of Hughes Center portfolio.
- (4) This loan has one one-year extension option.

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- (5) This includes two notes from Wachovia Securities. The notes are due November 2004, and bear interest at the LIBOR rate plus a spread of (i) 100.5 basis points for the \$31 million Wachovia note (at September 30, 2004, the interest rate was 2.765%), and (ii) 661.0 basis points for the \$14 million Wachovia note (at September 30, 2004, the interest rate was 8.37%). Both notes are secured by The Alhambra Office Property. The blended rate at September 30, 2004 for the two notes was 4.51%. In October 2004, the Company refinanced this loan with a \$50 million loan from Morgan Stanley for a 7-year interest only term at a fixed rate of 5.06%.
- (6) The outstanding balance excludes letters of credit issued under the credit facility of \$7.6 million.
- (7) The overall weighted average interest rate does not include the effect of the Company's cash flow hedge agreements. Including the effect of these agreements, the overall weighted average interest rate would have been 6.78%.

The Company is generally obligated by its debt agreements to comply with financial covenants, affirmative covenants and negative covenants, or some

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combination of these types of covenants. The financial covenants to which the Company is subject include, among others, leverage ratios, debt service coverage ratios and limitations on total indebtedness. The affirmative covenants to which the Company is subject under its debt agreements include, among others, provisions requiring the Company to comply with all laws relating to operation of any Properties securing the debt, maintain those Properties in good repair and working order, maintain adequate insurance and provide timely financial information. The negative covenants under the Company's debt agreements generally restrict the Company's ability to transfer or pledge assets or incur additional debt at a subsidiary level, limit the Company's ability to engage in transactions with affiliates and place conditions on the Company's or a subsidiary's ability to make distributions.

Failure to comply with covenants generally will result in an event of default under that debt instrument. Any uncured or unwaived events of default under the Company's loans can trigger an increase in interest rates, an acceleration of payment on the loan in default, and for the Company's secured debt, foreclosure on the property securing the debt, and could cause the credit facility to become unavailable to the Company. In addition, an event of default by the Company or any of its subsidiaries with respect to any indebtedness in excess of \$5.0 million generally will result in an event of default under the Credit Facility, 2007 Notes, 2009 Notes, Bank of America Fund XII Term Loan, the Fleet Fund I Term Loan and the Fleet Term Loan after the notice and cure periods for the other indebtedness have passed. As a result, any uncured or unwaived event of default could have an adverse effect on the Company's business, financial condition, or liquidity.

The Company's debt facilities generally prohibit loan prepayment for an initial period, allow prepayment with a penalty during a following specified period and allow prepayment without penalty after the expiration of that period. During the nine months ended September 30, 2004, there were no circumstances that required prepayment penalties or increased collateral related to the Company's existing debt.

On June 28, 2004, the Company paid off the \$220.0 million Deutsche Bank-CMBS loan with proceeds from the Fountain Place transaction and a draw on the Company's credit facility. See "Recent Developments," in this Item 2, for additional information regarding the Fountain Place transaction. The loan was secured by the Funding X Properties and Spectrum Center. In July 2004, the Company unwound the \$220.0 million interest rate cap with JP Morgan Chase that corresponded to this loan.

DEFEASANCE OF LASALLE NOTE II

In January 2004, the Company released the remaining properties in Funding II by reducing the Fleet Fund I and II Term Loan by \$104.2 million and purchasing an additional \$170.0 million of U.S. Treasury and government sponsored agency securities with an initial weighted average yield of 1.76%. The Company placed those securities into a collateral account for the sole purpose of funding payments of principal and interest on the remainder of the LaSalle Note II. The cash flow from the securities is structured to match the cash flow (principal and interest payments) required under the LaSalle Note II. The retirement of the Fleet loan and the purchase of the defeasance securities were funded through the \$275 million Bank of America Fund XII Term Loan. The collateral for the Bank of America loan was 10 of the 11 properties previously in the Funding II collateral pool. The Bank of America loan is structured to allow the Company the flexibility to sell, joint venture or long-term finance these 10 assets over the next 36 months. The final Funding II property, Liberty Plaza, was moved to the Operating Partnership and subsequently sold in April 2004.

UNCONSOLIDATED DEBT ARRANGEMENTS

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As of September 30, 2004, the total debt of the unconsolidated joint ventures and equity investments in which the Company has ownership interests was \$1.3 billion, of which the Company's share was \$472.5 million. The Company had guaranteed \$6.2 million of this debt as of September 30, 2004. Additional information relating to the Company's unconsolidated debt financing arrangements is contained in Note 8, "Investments in Unconsolidated Companies," of Item 1, "Financial Statements."

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DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

The Company uses derivative financial instruments to convert a portion of its variable rate debt to fixed rate debt and to manage its fixed to variable rate debt ratio. As of September 30, 2004, the Company had three cash flow hedge agreements which are accounted for in conformity with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities - an Amendment of FASB Statement No. 133."

The following table shows information regarding the Company's interest rate swaps designated as cash flow hedge agreements during the nine months ended September 30, 2004, and additional interest expense and unrealized gains (losses) recorded in Accumulated Other Comprehensive Income ("OCI").

EFFECTIVE DATE	NOTIONAL AMOUNT	MATURITY DATE	REFERENCE RATE	FAIR MARKET VALUE	ADDITIONAL EXPENSE
-----	-----	----	----	-----	---
(in thousands)					
4/18/00	\$ 100,000	4/18/04	6.76%	\$ -	\$ -
2/15/03	100,000	2/15/06	3.26%	(931)	
2/15/03	100,000	2/15/06	3.25%	(927)	
9/02/03	200,000	9/01/06	3.72%	(3,475)	

				\$ (5,333)	\$ -
				=====	=====

In addition, two of the Company's unconsolidated companies have cash flow hedge agreements of which the Company's portion of change in unrealized gains reflected in OCI was approximately \$0.6 million for the nine months ended September 30, 2004.

INTEREST RATE CAP

In March 2004, in connection with the Bank of America Fund XII Term Loan, the Company entered into a LIBOR interest rate cap struck at 6.00% for a notional amount of approximately \$206.3 million through August 31, 2004, \$137.5 million from September 1, 2004 through February 28, 2005, and \$68.8 million from March 1, 2005 through March 1, 2006. Simultaneously, the Company sold a LIBOR interest rate cap with the same terms. Since these instruments do not reduce the Company's net interest rate risk exposure, they do not qualify as hedges and changes to their respective fair values are charged to earnings as the changes occur. As the significant terms of these arrangements are the same, the effects of a revaluation of these instruments are expected to offset each other.

UNCONSOLIDATED INVESTMENTS

INVESTMENTS IN UNCONSOLIDATED COMPANIES

The following is a summary of the Company's ownership in significant unconsolidated joint ventures and investments as of September 30, 2004.

ENTITY	CLASSIFICATION
Main Street Partners, L.P.	Office (Bank One Center-Dallas)
Crescent Miami Center, L.L.C.	Office (Miami Center - Miami)
Crescent Five Post Oak Park L.P.	Office (Five Post Oak - Houston)
Crescent One BriarLake Plaza, L.P.	Office (BriarLake Plaza - Houston)
Crescent 5 Houston Center, L.P.	Office (5 Houston Center-Houston)
Austin PT BK One Tower Office Limited Partnership	Office (Bank One Tower-Austin)
Houston PT Three Westlake Office Limited Partnership	Office (Three Westlake Park - Houston)
Houston PT Four Westlake Office Limited Partnership	Office (Four Westlake Park-Houston)
Vornado Crescent Carthage and KC Quarry, L.L.C.	Temperature-Controlled Logistics
Vornado Crescent Portland Partnership	Temperature-Controlled Logistics
Blue River Land Company, L.L.C.	Other
Canyon Ranch Las Vegas, L.L.C.	Other
EW Deer Valley, L.L.C.	Other
CR License, L.L.C.	Other
CR License II, L.L.C.	Other
SunTx Fulcrum Fund, L.P.	Other
SunTx Capital Partners, L.P.	Other
G2 Opportunity Fund, L.P. ("G2")	Other

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- (1) The remaining 50% interest in Main Street Partners, L.P. is owned by Trizec Properties, Inc.
 - (2) The remaining 60% interest in Crescent Miami Center, L.L.C. is owned by an affiliate of a fund managed by JP Morgan Fleming Asset Management, Inc.
 - (3) The remaining 70% interest in Crescent Five Post Oak Park, L.P. is owned by an affiliate of General Electric Pension Fund Trust.
 - (4) The remaining 70% interest in Crescent One BriarLake Plaza, L.P. is owned by affiliates of JP Morgan Fleming Asset Management, Inc.
 - (5) The remaining 75% interest in Crescent 5 Houston Center, L.P. is owned by a pension fund advised by JP Morgan Fleming Asset Management, Inc.
 - (6) The remaining 80% interest in each of Austin PT BK One Tower Office Limited Partnership, Houston PT Three Westlake Office Limited Partnership and Houston PT Four Westlake Office Limited Partnership is owned by an affiliate of General Electric Pension Fund Trust.
 - (7) The remaining 44% in Vornado Crescent Carthage and KC Quarry, L.L.C. is owned by Vornado Realty Trust, L.P.
 - (8) The remaining 60% interest in Vornado Crescent Portland Partnership is

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owned by Vornado Realty Trust, L.P.

- (9) The remaining 50% interest in Blue River Land Company, L.L.C. is owned by parties unrelated to the Company. Blue River Land Company, L.L.C. was formed to acquire, develop and sell certain real estate property in Summit County, Colorado.
- (10) Of the remaining 50% interest in Canyon Ranch Las Vegas, L.L.C., 35% is owned by an affiliate of the management company of two of the Company's Resort/Hotel Properties and 15% is owned by the Company through its investments in CR License II, L.L.C. Canyon Ranch Las Vegas, L.L.C. operates a Canyon Ranch spa in a hotel in Las Vegas.
- (11) The remaining 58.3% interest in EW Deer Valley, L.L.C. is owned by parties unrelated to the Company. EW Deer Valley, L.L.C. was formed to acquire, hold and dispose of its 3.3% ownership interest in Empire Mountain Village, L.L.C. Empire Mountain Village, L.L.C. was formed to acquire, develop and sell certain real estate property at Deer Valley Ski Resort next to Park City, Utah.
- (12) The remaining 70% interest in CR License, L.L.C. is owned by an affiliate of the management company of two of the Company's Resort/Hotel Properties. CR License, L.L.C. owns the licensing agreement related to certain Canyon Ranch trade names and trademarks.
- (13) The remaining 70% interest in CR License II, L.L.C. is owned by an affiliate of the management company of two of the Company's Resort/Hotel Properties. CR License II, L.L.C. and its wholly-owned subsidiaries provide management and development consulting services to a variety of entities in the hospitality, real estate, and health and wellness industries.
- (14) Of the remaining 76.5% of SunTx Fulcrum Fund, 37.1% is owned by SunTx Capital Partners, L.P. and the remaining 39.4% is owned by a group of individuals unrelated to the Company. SunTx Fulcrum Fund, L.P.'s objective is to invest in a portfolio of acquisitions that offer the potential for substantial capital appreciation.
- (15) SunTx Capital Partners, L.P. is the general Partner of the SunTx Fulcrum Fund, L.P. The remaining 85.6% interest in SunTx Capital Partners, L.P. is owned by parties unrelated to the Company.
- (16) G2 was formed for the purpose of investing in commercial mortgage backed securities and other commercial real estate investments. The remaining 87.5% interest in G2 is owned by Goff-Moore Strategic Partners, L.P. ("GMSPLP") and by parties unrelated to the Company. G2 is managed and controlled by an entity that is owned equally by GMSPLP and GMAC Commercial Mortgage Corporation ("GMACCM"). The ownership structure of GMSPLP consists of an approximately 86% limited partnership interest owned directly and indirectly by Richard E. Rainwater, Chairman of the Board of Trust Managers of the Company, and an approximately 14% general partnership interest, of which approximately 6% is owned by Darla Moore, who is married to Mr. Rainwater, and approximately 6% is owned by John C. Goff, Vice-Chairman of the Company's Board of Trust Managers and Chief Executive Officer of the Company. The remaining approximately 2% general partnership interest is owned by unrelated parties.

TEMPERATURE-CONTROLLED LOGISTICS PROPERTIES

As of September 30, AmeriCold Logistics, LLC was owned 60% by Vornado

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Operating L.P. and 40% by a subsidiary of Crescent Operating, Inc. ("COPI"). As sole lessee of the Temperature-Controlled Logistics Properties, AmeriCold Logistics leases the Temperature-Controlled Logistics Properties from the Temperature-Controlled Logistics Corporation under three triple-net master leases, as amended. The Company has an indirect 40% ownership interest in the Temperature-Controlled Logistics Corporation. The Company has no interest in COPI or AmeriCold Logistics. On March 2, 2004, the Temperature-Controlled Logistics Corporation and AmeriCold Logistics amended the leases to further extend the deferred rent period to December 31, 2005, from December 31, 2004. The parties previously extended the deferred rent period to December 31, 2004 from December 31, 2003, on March 7, 2003.

Under terms of the leases, AmeriCold Logistics elected to defer \$40.0 million of the total \$120.4 million of rent payable for the nine months ended September 30, 2004. The Company's share of the deferred rent was \$16.0 million. The Company recognizes rental income from the Temperature-Controlled Logistics Properties when earned and collected and has not recognized the \$16.0 million of deferred rent in equity in net income of the Temperature-Controlled Logistics Properties for the nine months ended September 30, 2004. As of September 30, 2004, the Temperature-Controlled Logistics Corporation's deferred rent and valuation allowance from AmeriCold Logistics were \$122.4 million and \$114.4 million, respectively, of which the Company's portions were \$49.0 million and \$45.8 million, respectively.

On February 5, 2004, the Temperature-Controlled Logistics Corporation completed a \$254.4 million mortgage financing with Morgan Stanley Mortgage Capital Inc., secured by 21 of its owned and seven of its leased temperature-controlled logistics properties. The loan matures in April 2009, bears interest at LIBOR plus 295 basis points (with a LIBOR floor of 1.5% with respect to \$54.4 million of the loan) and requires principal payments of \$5.0 million annually. The net proceeds to the Temperature-Controlled Logistics Corporation were approximately \$225.0 million, after closing costs and the repayment of approximately \$12.9 million in existing mortgages. On February 6, 2004, the Temperature-Controlled Logistics Corporation distributed cash of approximately \$90.0 million to the Company.

See "Recent Developments," for information regarding the purchase by the Temperature-Controlled Logistics Corporation of all the ownership interests in AmeriCold Logistics, the termination of the three triple-net master leases, and the agreement to sell an interest in the Temperature-Controlled Logistics Corporation to the Yucaipa Companies.

SIGNIFICANT ACCOUNTING POLICIES

CRITICAL ACCOUNTING POLICIES

The Company's discussion and analysis of financial condition and results of operations is based on its consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, and contingencies as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. The Company evaluates its assumptions and estimates on an ongoing basis. The Company bases its estimates on historical experience and on various other assumptions that it believes to be reasonable under the circumstances. These estimates form the basis for making judgments about the carrying values of assets and liabilities where that information is available from other sources. Certain estimates are particularly sensitive due to their significance to the financial statements. Actual results may differ significantly from management's estimates.

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The Company believes that the most significant accounting policies that involve the use estimates and assumptions as to future uncertainties and, therefore, may result in actual amounts that differ from estimates are the following:

- Impairments,
- Acquisition of operating properties,
- Relative sales method and percentage of completion (Residential Development entities),
- Gain recognition on sale of real estate assets,
- Consolidation of variable interest entities, and
- Allowance for doubtful accounts.

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IMPAIRMENTS. Real estate and leasehold improvements are classified as long-lived assets held for sale or long-lived assets to be held and used. In accordance with SFAS No. 144, the Company records assets held for sale at the lower of carrying value or sales price less costs to sell. For assets classified as held and used, these assets are tested for recoverability when events or changes in circumstances indicate that the estimated carrying amount may not be recoverable. An impairment loss is recognized when expected undiscounted future cash flows from a Property is less than the carrying value of the Property. The Company's estimates of cash flows of the Properties requires the Company to make assumptions related to future rental rates, occupancies, operating expenses, the ability of the Company's tenants to perform pursuant to their lease obligations and proceeds to be generated from the eventual sale of the Company's Properties. Any changes in estimated future cash flows due to changes in the Company's plans or views of market and economic conditions could result in recognition of additional impairment losses.

If events or circumstances indicate that the fair value of an investment accounted for using the equity method has declined below its carrying value and the Company considers the decline to be "other than temporary," the investment is written down to fair value and an impairment loss is recognized. The evaluation of impairment for an investment would be based on a number of factors, including financial condition and operating results for the investment, inability to remain in compliance with provisions of any related debt agreements, and recognition of impairments by other investors. Impairment recognition would negatively impact the recorded value of our investment and reduce net income.

ACQUISITION OF OPERATING PROPERTIES. The Company allocates the purchase price of acquired properties to tangible and identified intangible assets acquired based on their fair values in accordance with SFAS No. 141, "Business Combinations."

In making estimates of fair value for purposes of allocating purchase price, management utilizes sources, including, but not limited to, independent value consulting services, independent appraisals that may be obtained in connection with financing the respective property, and other market data. Management also considers information obtained about each property as a result of its pre-acquisition due diligence, marketing and leasing activities in estimating the fair value of the tangible and intangible assets acquired.

The aggregate value of the tangible assets acquired is measured based on

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the sum of (i) the value of the property and (ii) the present value of the amortized in-place tenant improvement allowances over the remaining term of each lease. Management's estimates of the value of the property are made using models similar to those used by independent appraisers. Factors considered by management in its analysis include an estimate of carrying costs such as real estate taxes, insurance, and other operating expenses and estimates of lost rentals during the expected lease-up period assuming current market conditions. The value of the property is then allocated among building, land, site improvements, and equipment. The value of tenant improvements is separately estimated due to the different depreciable lives.

The aggregate value of intangible assets acquired is measured based on the difference between (i) the purchase price and (ii) the value of the tangible assets acquired as defined above. This value is then allocated among above-market and below-market in-place lease values, costs to execute similar leases (including leasing commissions, legal expenses and other related expenses), in-place lease values and customer relationship values.

Above-market and below-market in-place lease values for acquired properties are calculated based on the present value (using a market interest rate which reflects the risks associated with the leases acquired) of the difference between (i) the contractual amounts to be paid pursuant to the in-place leases and (ii) management's estimate of fair market lease rates for the corresponding in-place leases, measured over a period equal to the remaining non-cancelable term of the lease for above-market leases and the initial term plus the term of the below-market fixed rate renewal option, if any, for below-market leases. The Company performs this analysis on a lease by lease basis. The capitalized above-market lease values are amortized as a reduction to rental income over the remaining non-cancelable terms of the respective leases. The capitalized below-market lease values are amortized as an increase to rental income over the initial term plus the term of the below-market fixed rate renewal option, if any, of the respective leases.

Management estimates costs to execute leases similar to those acquired at the property at acquisition based on current market conditions. These costs are recorded based on the present value of the amortized in-place leasing costs on a lease by lease basis over the remaining term of each lease.

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The in-place lease values and customer relationship values are based on management's evaluation of the specific characteristics of each customer's lease and the Company's overall relationship with that respective customer. Characteristics considered by management in allocating these values include the nature and extent of the Company's existing business relationships with the customer, growth prospects for developing new business with the customer, the customer's credit quality, and the expectation of lease renewals, among other factors. The in-place lease value and customer relationship value are both amortized to expense over the initial term of the respective leases and projected renewal periods, but in no event does the amortization period for the intangible assets exceed the remaining depreciable life of the building.

Should a tenant terminate its lease, the unamortized portion of the in-place lease value and the customer relationship value and above-market and below-market in-place lease values would be charged to expense.

RELATIVE SALES METHOD AND PERCENTAGE OF COMPLETION. The Company uses the accrual method to recognize earnings from the sale of Residential Development Properties when a third-party buyer had made an adequate cash down payment and has attained the attributes of ownership. If a sale does not qualify for the accrual method of recognition, deferral methods are used as appropriate

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including the percentage-of-completion method. In certain cases, when the Company receives an inadequate cash down payment and takes a promissory note for the balance of the sales price, revenue recognition is deferred until such time as sufficient cash is received to meet minimum down payment requirements. The cost of residential property sold is defined based on the type of product being purchased. The cost of sales for residential lots is generally determined as a specific percentage of the sales revenues recognized for each Residential Development project. The percentages are based on total estimated development costs and sales revenue for each Residential Development project. These estimates are revised annually and are based on the then-current development strategy and operating assumptions utilizing internally developed projections for product type, revenue and related development costs. The cost of sale for residential units (such as townhomes and condominiums) is determined using the relative sales value method. If the residential unit has been sold prior to the completion of infrastructure cost, and those uncompleted costs are not significant in relation to total costs, the full accrual method is utilized. Under this method, 100% of the revenue is recognized, and a commitment liability is established to reflect the allocated estimated future costs to complete the residential unit. If the Company's estimates of costs or the percentage of completion is incorrect, it could result in either an increase or decrease in cost of sales expense or revenue recognized and therefore, an increase or decrease in net income.

GAIN RECOGNITION ON SALE OF REAL ESTATE ASSETS. The Company performs evaluations of each real estate sale to determine if full gain recognition is appropriate in accordance with SFAS No. 66, "Accounting for Sales of Real Estate." The application of SFAS No. 66 can be complex and requires the Company to make assumptions including an assessment of whether the risks and rewards of ownership have been transferred, the extent of the purchaser's investment in the property being sold, whether the Company's receivables, if any, related to the sale are collectible and are subject to subordination, and the degree of the Company's continuing involvement with the real estate asset after the sale. If full gain recognition is not appropriate, the Company accounts for the sale under an appropriate deferral method.

CONSOLIDATION OF VARIABLE INTEREST ENTITIES. On January 15, 2003, the FASB approved the issuance of Interpretation 46, "Consolidation of Variable Interest Entities," ("FIN 46"), an interpretation of Accounting Research Bulletin No. 51, "Consolidated Financial Statements." In December 2003, the FASB issued FIN 46R, "Consolidation of Variable Interest Entities" ("FIN 46R"), which amended FIN 46. Under FIN 46R, consolidation requirements are effective immediately for new Variable Interest Entities ("VIEs") created after January 31, 2003. The consolidation requirements apply to existing VIEs for financial periods ending after March 15, 2004, except for special purpose entities which had to be consolidated by December 31, 2003. VIEs are generally a legal structure used for business enterprises that either do not have equity investors with voting rights, or have equity investors that do not provide sufficient financial resources for the entity to support its activities. The objective of the new guidance is to improve reporting by addressing when a company should include in its financial statements the assets, liabilities and activities of other entities such as VIEs. FIN 46R requires VIEs to be consolidated by a company if the company is subject to a majority of the expected losses of the VIE's activities or entitled to receive a majority of the entity's expected residual returns or both.

The adoption of FIN 46R did not have a material impact to the Company's financial condition or results of operations. Due to the adoption of this Interpretation and management's assumptions in application of the guidelines stated in the Interpretation, the Company has consolidated GDW LLC, a subsidiary

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of DMDC, as of December 31, 2003 and Elijah Fulcrum Fund Partners, L.P. ("Elijah") as of January 1, 2004. Elijah is a limited partnership whose purpose is to invest in the SunTx Fulcrum Fund, L.P. SunTx Fulcrum Fund, L.P.'s objective is to invest in a portfolio of acquisitions that offer the potential for substantial capital appreciation. While it was determined that one of the Company's unconsolidated joint ventures, Main Street Partners, L.P., and its investments in Canyon Ranch Las Vegas, L.L.C., CR License, L.L.C. and CR License II, L.L.C. ("Canyon Ranch Entities") are VIEs under FIN 46R, the Company is not the primary beneficiary and is not required to consolidate these entities under other GAAP. The Company's maximum exposure to loss is limited to its equity investment of approximately \$57.7 million in Main Street Partners, L.P. and \$5.1 million in the Canyon Ranch Entities at September 30, 2004.

During 2004, the Company entered into three separate exchange agreements with a third party intermediary. The first exchange agreement included two parcels of undeveloped land, the second exchange agreement included the 3930 Hughes Parkway Office Property, and the third exchange agreement included The Alhambra Office Property. The agreements were for a maximum term of 180 days and allow the Company to pursue favorable tax treatment on other properties sold by the Company within this period. During the 180-day periods, which ended or will end on August 28, 2004, November 6, 2004, and February 2, 2005, respectively, the third party intermediary is the legal owner of the properties, although the Company controls the properties, retains all of the economic benefits and risks associated with these properties and indemnifies the third party intermediary and, therefore, the Company fully consolidates these properties. The Company took or will take legal ownership of the properties no later than on the expiration of the 180-day period.

ALLOWANCE FOR DOUBTFUL ACCOUNTS. The Company's accounts receivable balance is reduced by an allowance for amounts that may become uncollectible in the future. The Company's receivable balance is composed primarily of rents and operating cost recoveries due from its tenants. The Company also maintains an allowance for deferred rent receivables which arise from the straight-lining of rents. The allowance for doubtful accounts is reviewed at least quarterly for adequacy by reviewing such factors as the credit quality of the Company's tenants, any delinquency in payment, historical trends and current economic conditions. If the assumptions regarding the collectibility of accounts receivable prove incorrect, the Company could experience write-offs in excess of its allowance for doubtful accounts, which would result in a decrease in net income.

ADOPTION OF NEW ACCOUNTING STANDARD

EITF 03-1. At the March 17-18, 2004 meeting, consensus was reached by the FASB Emerging Issues Task Force on EITF 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments." The Consensus applies to investments in debt and equity securities within the scope of SFAS Nos. 115, "Accounting for Certain Investments in Debt and Equity Securities," and 124, "Accounting for Certain Investments Held by Not-for-Profit Organizations." It also applies to investments in equity securities that are both outside SFAS No. 115's scope and not accounted for under the equity method. The Task Force reached a consensus that certain quantitative and qualitative disclosures should be required for securities that are impaired at the balance sheet date but for which an other-than-temporary impairment has not been recognized. The new impairment guidance creates a model that calls for many judgments and additional evidence gathering in determining whether or not securities are other-than-temporarily impaired and lists some of these impairment indicators. The impairment accounting guidance is effective for periods beginning after June 15, 2004 and the disclosure requirements for annual reporting periods are effective for periods ending after June 15, 2004. The Company adopted EITF 03-1 effective July 1, 2004 and it had no impact on the Company's financial condition or its results of operations.

FUNDS FROM OPERATIONS

FFO, as used in this document, means:

- Net Income (Loss) - determined in accordance with GAAP;
- excluding gains (or losses) from sales of depreciable operating property;
- excluding extraordinary items (as defined by GAAP);
- plus depreciation and amortization of real estate assets; and
- after adjustments for unconsolidated partnerships and joint ventures.

The Company calculates FFO available to common shareholders - diluted in the same manner, except that Net Income (Loss) is replaced by Net Income (Loss) Available to Common Shareholders and the Company includes the effect of operating partnership unitholder minority interests.

The National Association of Real Estate Investment Trusts ("NAREIT") developed FFO as a relative measure of performance and liquidity of an equity REIT to recognize that income-producing real estate historically has not depreciated on the basis determined under GAAP. The Company considers FFO available to common shareholders - diluted and FFO appropriate measures of performance for an equity REIT and for its investment segments. However, FFO available to common shareholders - diluted and FFO should not be considered an alternative to net income determined in accordance with GAAP as an indication of the Company's operating performance.

The aggregate cash distributions paid to common shareholders and unitholders for the nine months ended September 30, 2004 and 2003 were \$131.7 million and \$131.6 million, respectively. The Company reported FFO available to common shareholders before impairments charges related to real estate assets - diluted of \$89.9 million and \$121.3 million, for the nine months ended September 30, 2004 and 2003, respectively. The Company reported FFO available to common shareholders after impairments charges related to real estate assets - diluted of \$84.2 million and \$100.9 million, for the nine months ended September 30, 2004 and 2003, respectively.

An increase or decrease in FFO available to common shareholders - diluted does not necessarily result in an increase or decrease in aggregate distributions because the Company's Board of Trust Managers is not required to increase distributions on a quarterly basis unless necessary for the Company to maintain REIT status. However, the Company must distribute 90% of its REIT taxable income (as defined in the Code). Therefore, a significant increase in FFO available to common shareholders - diluted will generally require an increase in distributions to shareholders and unitholders although not necessarily on a proportionate basis.

Accordingly, the Company believes that to facilitate a clear understanding of the consolidated historical operating results of the Company, FFO available to common shareholders - diluted should be considered in conjunction with the Company's net income and cash flows reported in the consolidated financial statements and notes to the financial statements. However, the Company's measure of FFO available to common shareholders - diluted may not be comparable to similarly titled measures of other REITs because these REITs may apply the definition of FFO in a different manner than the Company.

CONSOLIDATED STATEMENTS OF FUNDS FROM OPERATIONS
(in thousands)

	FOR THE THREE MONTHS SEPTEMBER 30,	
	2004	2003
	-----	-----
Net (loss) income	\$ (10,673)	\$ 3,330
Adjustments to reconcile net (loss) income to funds from operations available to common shareholders - diluted:		
Depreciation and amortization of real estate assets	42,984	39,812
Loss on property sales, net	193	
Impairment charges related to real estate assets and assets held for sale	2,847	2,847
Adjustment for investments in unconsolidated companies:		
Office Properties	2,283	(1,111)
Resort/Hotel Properties	-	
Residential Development Properties	(2,150)	
Temperature-Controlled Logistics Properties	5,768	5,768
Other	-	
Unitholder minority interest	(1,912)	
Series A Preferred Share distributions	(5,991)	(4,991)
Series B Preferred Share distributions	(2,019)	(2,019)
	-----	-----
Funds from operations available to common shareholders before impairment charges related to real estate assets - diluted(1)	\$ 31,330	\$ 43,737
Impairment charges related to real estate assets	(2,847)	(2,847)
	-----	-----
Funds from operations available to common shareholders after impairment charges related to real estate assets - diluted(1)	\$ 28,483	\$ 40,890
	=====	=====
Investment Segments:		
Office Properties	\$ 68,410	\$ 73,410
Resort/Hotel Properties	12,272	11,272
Residential Development Properties	3,779	2,779
Temperature-Controlled Logistics Properties	4,862	4,862
Other:		
Corporate general and administrative	(9,023)	(7,023)
Interest expense	(46,571)	(43,571)
Series A Preferred Share distributions	(5,991)	(4,991)
Series B Preferred Share distributions	(2,019)	(2,019)
Other(2)	5,611	8,611
	-----	-----
Funds from operations available to common shareholders before impairment charges related to real estate assets - diluted(1)	\$ 31,330	\$ 43,737
Impairment charges related to real estate assets	(2,847)	(2,847)
	-----	-----
Funds from operations available to common shareholders after impairment charges related to real estate assets - diluted(1)	\$ 28,483	\$ 40,890
	=====	=====
Basic weighted average shares	99,024	99,024
Diluted weighted average shares and units(3)	116,864	116,864

-
- (1) To calculate basic funds from operations exclude unitholder minority interest.
 - (2) Includes income from investment land sales, net, interest and other income, income/loss from other unconsolidated companies, other expenses, depreciation and amortization of non-real estate assets and amortization of deferred financing costs.
 - (3) See calculations for the amounts presented in the reconciliation following this table.

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The following schedule reconciles the Company's basic weighted average shares to the diluted weighted average shares/units presented above:

	FOR THE THREE MONTHS ENDED SEPTEMBER 30,	
(shares/units in thousands)	2004	2003
	-----	-----
Basic weighted average shares:	99,024	99,172
Add: Weighted average units	17,728	17,747
Restricted shares and share and unit options	112	10
	-----	-----
Diluted weighted average shares and units	116,864	116,929
	=====	=====

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

No material changes in the Company's market risk occurred from December 31, 2003 through September 30, 2004. Information regarding the Company's market risk at December 31, 2003 is contained in Item 7A, "Quantitative and Qualitative Disclosures About Market Risk," in the Company's Annual Report on Form 10-K for the year ended December 31, 2003.

ITEM 4. CONTROLS AND PROCEDURES

DISCLOSURE CONTROLS AND PROCEDURES. The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the Company's reports under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), such as this report on Form 10-Q, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to the Company's management, including its Chief Executive Officer and its Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. These controls and procedures are based closely on the definition of "disclosure controls and procedures" in Rule 13a-15(e) promulgated under the Exchange Act. Rules adopted by the SEC require that the Company present the conclusions of the Chief Executive Officer and Chief Financial Officer about the effectiveness of the Company's disclosure controls and procedures as of the end of the period covered by this quarterly report.

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INTERNAL CONTROL OVER FINANCIAL REPORTING. Internal control over financial reporting is a process designed by, or under the supervision of, the Company's Chief Executive Officer and Chief Financial Officer, as appropriate, and effected by the Company's employees, including management and the Company's Board of Trust Managers, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. This process includes policies and procedures that:

- o pertain to the maintenance of records that accurately and fairly reflect the transactions and dispositions of the Company's assets in reasonable detail;
- o provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that the Company's receipts and expenditures are made only in accordance with the authorization procedures the Company has established; and
- o provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of any of the Company's assets in circumstances that could have a material adverse effect on the Company's financial statements.

LIMITATIONS ON THE EFFECTIVENESS OF CONTROLS. Management, including the Company's Chief Executive Officer and Chief Financial Officer, do not expect that the Company's disclosure controls and procedures or internal control over financial reporting will prevent all errors and fraud. In designing and evaluating the Company's control system, management recognized that any control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance of achieving the desired control objectives. Further, the design of a control system must reflect the fact that there are resource constraints, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, that may affect the Company's operation have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management's override of the control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that the Company's design will succeed in achieving its stated goals under all potential future conditions. Over time, the Company's current controls may become inadequate because of changes in conditions that cannot be anticipated at the present time, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

SCOPE OF THE EVALUATION OF THE COMPANY'S DISCLOSURE CONTROLS AND PROCEDURES. As of September 30, 2004, the Company carried out an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures. This evaluation of the Company's disclosure controls and procedures included a review of procedures and the Company's internal audit, as well as discussions with the Company's Disclosure Committee, and others in the Company, as appropriate. In the course of the evaluation, the Company sought to identify data errors, control problems or acts of fraud and to confirm that appropriate corrective action, including process improvements, were being undertaken. The overall goals of these various evaluation activities are to monitor the Company's disclosure controls and procedures and to make

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modifications as necessary. The Company's intent in this regard is that the disclosure controls and procedures will be maintained as systems that change (including with improvements and corrections) as conditions warrant. Among other matters, the Company sought in this evaluation to determine whether there were any "significant deficiencies" or "material weaknesses" in the Company's internal control over financial reporting, or whether the Company had identified any acts of fraud involving personnel who have a significant role in the Company's internal control over financial reporting. The Company also sought to deal with other control matters in the evaluation, and in any case in which a problem was identified, management considered what revision, improvement and/or correction was necessary to be made in accordance with the Company's on-going procedures.

PERIODIC EVALUATION AND CONCLUSION OF DISCLOSURE CONTROLS AND PROCEDURES. As of September 30, 2004, the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including its Chief Executive Officer and its Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that such controls and procedures were effective as of September 30, 2004.

SCOPE OF THE EVALUATION OF THE COMPANY'S INTERNAL CONTROL OVER FINANCIAL REPORTING. As with the Company's evaluation of its disclosure controls and procedures, the evaluation by the Company's Chief Executive Officer and Chief Financial Officer of the Company's internal control over financial reporting included a review, in conjunction with the Company's internal auditors and others in the Company's organization, of the Company's procedures relating to the reliability of the Company's financial reporting and preparation of the Company's financial statements in accordance with generally accepted accounting principles ("GAAP"). Among other matters, the Company sought in its evaluation to determine whether there were any "significant deficiencies" or "material weaknesses" in its internal control over financial reporting, or whether the Company had identified any acts of fraud involving personnel who have a significant role in the Company's internal control over financial reporting. This information is important both for the evaluation generally and because the Section 302 certifications require that the Company's Chief Executive Officer and Chief Financial Officer disclose that information to the Audit Committee of the Board of Trust Managers and the Company's independent auditors and also require the Company to report on related matters in this section of the report on Form 10-Q. In the professional auditing literature, "significant deficiencies" are referred to as "reportable conditions"; these are control issues that could have a significant adverse effect on the Company's ability to record, process, summarize and report financial data reliably, in accordance with GAAP, in the Company's external financial statements. A "material weakness" is defined in the auditing literature as a significant deficiency where the internal control does not reduce to a relatively low risk that misstatements caused by error or fraud may occur in amounts that would be material in relation to the financial statements and would not be detected within a timely period by employees in the normal course of performing their assigned functions. In addition to evaluating the Company's internal control over financial reporting, the Company has devoted significant resources to documenting its internal control design and to testing the effectiveness of its internal control processes. In connection with this documentation and testing, the Company has made changes to improve the effectiveness of its internal controls over financial reporting, including changes in the underlying controls and its documentation of existing controls.

Management identified and reported to the Audit Committee of the Company's Board of Trust Managers certain deficiencies in the operations of internal controls at entities in which the Company invests but which are managed by third parties, such as Crescent Resort Development, Inc. ("CRDI") and Ventana Inn &

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Spa. Management identified deficiencies at CRDI and Ventana Inn & Spa in the course of performing documentation and testing phases of the internal controls of these entities. These deficiencies included the lack of segregation of management and accounting responsibilities, lack of timely reconciliations and deficiencies in the design and operation of general computer controls and, in a number of cases, incomplete account analysis. Management does not believe that these deficiencies had an impact on the accuracy of the Company's financial statements. The Company and the management of CRDI and Ventana Inn & Spa are working together to correct these identified deficiencies through alternatives such as hiring additional accounting staff to mitigate the lack of segregation and enhance the account reconciliation and account analysis process.

The Company is continuing its evaluation, documentation and testing of the Company's internal control over financial reporting so that management will be able to report on, and the Company's independent auditors will be able to attest to, the Company's internal control over financial reporting as of December 31, 2004, as required by applicable laws and regulations, and the Company will continue to remediate its internal controls to the extent that the Company's testing reveals inadequacies in its controls. Management believes that the Company has adequate internal control over financial reporting but cannot be certain that the identified deficiencies at CRDI or Ventana Inn & Spa will not result in a management assessment that there is a material weakness in its internal controls over financial reporting for these entities at the end of the year or, since there is no precedent available by which the Company can measure the adequacy of its control system in advance, that the Company or the Company's independent auditors will be able to complete all the required testing of controls to attest to the Company's assessment of these controls on a timely basis.

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING. During the period ended September 30, 2004, there was no change in the Company's internal control over financial reporting that materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

During the three months ended September 30, 2004, the Company issued an aggregate of 18,916 common shares to holders of Operating Partnership units in exchange for 9,458 units. All of the common shares were issued on August 3, 2004. The issuances of common shares were exempt from registration as private placements under Section 4(2) of the Securities Act of 1933, as amended (the "Securities Act"). The Company has registered the resale of such common shares under the Securities Act.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

The exhibits required by this item are set forth on the Exhibit Index attached hereto.

(b) Reports on Form 8-K

None.

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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.

CRESCENT REAL ESTATE EQUITIES COMPANY
(Registrant)

By /s/ John C. Goff

Date: November 8, 2004

John C. Goff
Vice-Chairman of the Board and Chief
Executive Officer

By /s/ Jerry R. Crenshaw, Jr.

Date: November 8, 2004

Jerry R. Crenshaw, Jr.
Executive Vice President and Chief
Financial Officer (Principal Financial
and Accounting Officer)

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INDEX TO EXHIBITS

EXHIBIT NUMBER	DESCRIPTION OF EXHIBIT
3.01	Restated Declaration of Trust of Crescent Real Estate Equities Company, as amended (filed as Exhibit No. 3.1 to the Registrant's Current Report on Form 8-K filed April 25, 2002 (the "April 2002 8-K") and incorporated herein by reference)
3.02	Second Amended and Restated Bylaws of Crescent Real Estate Equities Company (filed as Exhibit No. 3.02 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2003 and incorporated herein by reference)
4.01	Form of Common Share Certificate (filed as Exhibit No. 4.03 to the Registrant's Registration Statement on Form S-3 (File No. 333-21905) and incorporated herein by reference)
4.02	Statement of Designation of 6-3/4% Series A Convertible Cumulative Preferred Shares of Crescent Real Estate Equities Company dated February 13, 1998 (filed as Exhibit No. 4.07 to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 1997 and incorporated herein by reference)
4.03	Form of Certificate of 6-3/4% Series A Convertible Cumulative Preferred Shares of Crescent Real Estate Equities Company (filed as Exhibit No. 4 to the Registrant's Registration Statement on Form 8-A/A filed on February 18, 1998 and incorporated by reference)
4.04	Statement of Designation of 6-3/4% Series A Convertible Cumulative Preferred Shares of Crescent Real Estate Equities Company dated April 25, 2002 (filed as Exhibit No. 4.1 to the April 2002 8-K and incorporated herein by reference)
4.05	Statements of Designation of 6-3/4% Series A Convertible Cumulative Preferred Shares of Crescent Real Estate Equities Company dated

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January 14, 2004 (filed as Exhibit No. 4.1 to the Registrant's Current Report on Form 8-K filed January 15, 2004 (the "January 2004 8-K") and incorporated herein by reference)

- 4.06 Form of Global Certificate of 6-3/4 Series A Convertible Cumulative Preferred Shares of Crescent Real Estate Equities Company (filed as Exhibit No. 4.2 to the January 2004 8-K and incorporated herein by reference)
- 4.07 Statement of Designation of 9.50% Series B Cumulative Redeemable Preferred Shares of Crescent Real Estate Equities Company dated May 13, 2002 (filed as Exhibit No. 2 to the Registrant's Form 8-A dated May 14, 2002 (the "Form 8-A") and incorporated herein by reference)
- 4.08 Form of Certificate of 9.50% Series B Cumulative Redeemable Preferred Shares of Crescent Real Estate Equities Company (filed as Exhibit No. 4 to the Form 8-A and incorporated herein by reference)
- *4 Pursuant to Regulation S-K Item 601 (b) (4) (iii), the Registrant by this filing agrees, upon request, to furnish to the Securities and Exchange Commission a copy of instruments defining the rights of holders of long-term debt of the Registrant
- 31.01 Certifications of Chief Executive Officer and Chief Financial Officer pursuant to Rule 13a - 14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith)
- 32.01 Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith)