

ESSEX PROPERTY TRUST INC
Form 10-Q
May 12, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2014

OR

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

For the transition period from _____ to _____

Commission file number 001-13106

ESSEX PROPERTY TRUST, INC.

ESSEX PORTFOLIO, L.P.

(Exact name of Registrant as Specified in its Charter)

Maryland (Essex Property Trust, Inc.)

77-0369576 (Essex Property Trust, Inc.)

California (Essex Portfolio, L.P.)

77-0369575 (Essex Portfolio, L.P.)

(State or Other Jurisdiction of Incorporation or Organization) (I.R.S. Employer Identification Number)

925 East Meadow Drive

Palo Alto, California 94303

(Address of Principal Executive Offices including Zip Code)

(650) 494-3700

(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file reports), and (2) has been subject to such filing requirements for the past 90 days.

Essex Property Trust, Inc. Yes No Essex Portfolio, L.P. Yes No

Edgar Filing: ESSEX PROPERTY TRUST INC - Form 10-Q

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Essex Property Trust, Inc. Yes No Essex Portfolio, L.P. Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Edgar Filing: ESSEX PROPERTY TRUST INC - Form 10-Q

Essex Property Trust, Inc.:

Non-accelerated filer
Large accelerated filer Accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

Essex Portfolio, L.P.:

Non-accelerated filer Smaller reporting company
Large accelerated filer Accelerated filer (Do not check if a smaller reporting company)
(Do not check if a smaller reporting company)

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

Essex Property Trust, Inc. Yes No Essex Portfolio, L.P. Yes No

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 62,513,605 shares of Common Stock (\$0.0001 par value) of Essex Property Trust, Inc. were outstanding as of May 8, 2014.

ii

EXPLANATORY NOTE

This report combines the reports on Form 10-Q for the quarterly period ended March 31, 2014 of Essex Property Trust, Inc. and Essex Portfolio, L.P. Unless stated otherwise or the context otherwise requires, references to “Essex” mean Essex Property Trust, Inc., a Maryland corporation that operates as a self-administered and self-managed real estate investment trust (“REIT”), and references to “EPLP” mean Essex Portfolio, L.P. (the “Operating Partnership”). References to the “Company,” “we,” “us” or “our” mean collectively Essex, EPLP and those entities/subsidiaries owned or controlled by Essex and/or EPLP. References to the “Operating Partnership” mean collectively EPLP and those entities/subsidiaries owned or controlled by EPLP.

Essex is the general partner of EPLP and as the sole general partner of EPLP, Essex has exclusive control of EPLP's day-to-day management.

The Company is structured as an umbrella partnership REIT (“UPREIT”) and Essex contributes all net proceeds from its various equity offerings to the Operating Partnership. In return for those contributions, Essex receives a number of OP Units (see definition below) in the Operating Partnership equal to the number of shares of common stock it has issued in the equity offering. Contributions of properties to the Company can be structured as tax-deferred transactions through the issuance of OP Units in the Operating Partnership, which is one of the reasons why the Company is structured in the manner outlined above. Based on the terms of EPLP's partnership agreement, OP Units can be exchanged with Essex common stock on a one-for-one basis. The Company maintains a one-for-one relationship between the OP Units of the Operating Partnership issued to Essex and shares of common stock.

The Company believes that combining the reports on Form 10-Q of Essex and EPLP into this single report provides the following benefits:

- enhances investors' understanding of the Company and the Operating Partnership by enabling investors to view the business as a whole in the same manner as management views and operates the business;
- eliminates duplicative disclosure and provides a more streamlined and readable presentation since a substantial portion of the disclosure applies to both the Company and the Operating Partnership; and
- creates time and cost efficiencies through the preparation of one combined report instead of two separate reports

Management operates the Company and the Operating Partnership as one business. The management of Essex consists of the same members as the management of EPLP.

All of the Company's property ownership, development and related business operations are conducted through the Operating Partnership and Essex has no material assets, other than its investment in EPLP. Essex's primary function is acting as the general partner of EPLP. As general partner with control of the Operating Partnership, the Company consolidates the Operating Partnership for financial reporting purposes. Therefore, the assets and liabilities of the Company and the Operating Partnership are the same on their respective financial statements. Essex also issues equity from time to time and guarantees certain debt of EPLP, as disclosed in this report. The Operating Partnership holds substantially all of the assets of the Company, including the Company's ownership interests in its joint ventures. The Operating Partnership conducts the operations of the business and is structured as a partnership with no publicly traded equity. Except for the net proceeds from equity offerings by the Company, which are contributed to the capital of the Operating Partnership in exchange for additional limited partnership interests in the Operating Partnership (“OP Units”) (on a one-for-one share of common stock per OP Unit basis), the Operating Partnership generates all remaining capital required by the Company's business. These sources include the Operating Partnership's working capital, net cash provided by operating activities, borrowings under its revolving credit facility, the issuance of secured and unsecured debt and equity securities and proceeds received from disposition of certain properties and joint ventures.

The Company believes it is important to understand the few differences between Essex and EPLP in the context of how Essex and EPLP operate as a consolidated company. Stockholders' equity, partners' capital and noncontrolling

interest are the main areas of difference between the consolidated financial statements of the Company and those of the Operating Partnership. The limited partners of the Operating Partnership are accounted for as partners' capital in the Operating Partnership's consolidated financial statements and as noncontrolling interest in the Company's consolidated financial statements. The noncontrolling interest in the Operating Partnership's consolidated financial statements include the interest of unaffiliated partners in various consolidated partnerships and joint venture partners. The noncontrolling interest in the Company's consolidated financial statements include (i) the same noncontrolling interest as presented in the Operating Partnership's consolidated financial statements and (ii) limited partner OP Unitholders of the Operating Partnership. The differences between stockholders' equity and partners' capital result from differences in the equity issued at the Company and Operating Partnership levels.

iii

To help investors understand the significant differences between the Company and the Operating Partnership, this report provides separate consolidated financial statements for the Company and the Operating Partnership; a single set of consolidated notes to such financial statements that includes separate discussions of stockholders' equity or partners' capital, and earnings per share/unit; as applicable; and a combined Management's Discussion and Analysis of Financial Condition and Results of Operations.

This report also includes separate Part I, Item 4. Controls and Procedures sections and separate Exhibits 31 and 32 certifications for each of the Company and the Operating Partnership in order to establish that the requisite certifications have been made and that the Company and the Operating Partnership are compliant with Rule 13a-15 or Rule 15d-15 of the Securities Exchange Act of 1934 and 18 U.S.C. §1350.

In order to highlight the differences between the Company and the Operating Partnership, the separate sections in this report for the Company and the Operating Partnership specifically refer to the Company and the Operating Partnership. In the sections that combine disclosure of the Company and the Operating Partnership, this report refers to actions or holdings as being actions or holdings of the Company. Although the Operating Partnership is generally the entity that directly or indirectly enters into contracts and joint ventures and holds assets and debt, reference to the Company is appropriate because the Company is one business and the Company operates that business through the Operating Partnership. The separate discussions of the Company and the Operating Partnership in this report should be read in conjunction with each other to understand the results of the Company on a consolidated basis and how management operates the Company.

The information furnished in the accompanying unaudited condensed consolidated balance sheets, statements of operations and comprehensive income, equity, capital, and cash flows of the Company and the Operating Partnership reflect all adjustments which are, in the opinion of management, necessary for a fair presentation of the aforementioned condensed consolidated financial statements for the interim periods and are normal and recurring in nature, except as otherwise noted.

The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the notes to such unaudited condensed consolidated financial statements and Management's Discussion and Analysis of Financial Condition and Results of Operations herein. Additionally, these unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements included in the Company's annual report on Form 10-K for the year ended December 31, 2013.

iv

ESSEX PROPERTY TRUST, INC.
 ESSEX PORTFOLIO, L.P.
 FORM 10-Q
 INDEX

| | Page No. |
|--|-------------|
| PART I. FINANCIAL INFORMATION | |
| Item 1. Condensed Financial Statements of Essex Property Trust, Inc. (Unaudited) | |
| <u>Condensed Consolidated Balance Sheets as of March 31, 2014 and December 31, 2013</u> | 2 |
| <u>Condensed Consolidated Statements of Operations and Comprehensive Income for the three months ended March 31, 2014 and 2013</u> | 3 |
| <u>Condensed Consolidated Statement of Equity for the three months ended March 31, 2014</u> | 4 |
| <u>Condensed Consolidated Statements of Cash Flows for the three months ended March 31, 2014 and 2013</u> | 5 |
| Condensed Financial Statements of Essex Portfolio L.P. (Unaudited) | |
| <u>Condensed Consolidated Balance Sheets as of March 31, 2014 and December 31, 2013</u> | 7 |
| <u>Condensed Consolidated Statements of Operations and Comprehensive Income for the three months ended March 31, 2014 and 2013</u> | 8 |
| <u>Condensed Consolidated Statement of Capital for the three months ended March 31, 2014</u> | 9 |
| <u>Consolidated Statements of Cash Flows for the three months ended March 31, 2014 and 2013</u> | 10 |
| <u>Notes to Consolidated Financial Statements</u> | 12 |
| Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 25 |
| Item 3. <u>Quantitative and Qualitative Disclosures About Market Risks</u> | 34 |
| Item 4. <u>Controls and Procedures</u> | 35 |
| PART II. OTHER INFORMATION | |
| Item 1. <u>Legal Proceedings</u> | 36 |
| Item 1A. <u>Risk Factors</u> | 36 |
| Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | 36 |
| Item 6. <u>Exhibits</u> | 37 |

Signatures

1

Index

Part I – Financial Information

Item 1. Condensed Financial Statements

ESSEX PROPERTY TRUST, INC. AND SUBSIDIARIES

Condensed Consolidated Balance Sheets

(Unaudited)

(Dollars in thousands, except share amounts)

| | March 31, 2014 | December 31, 2013 |
|---|-------------------|-------------------------|
| Assets | | |
| Real estate: | | |
| Rental properties: | | |
| Land and land improvements | \$1,354,748 | \$1,083,552 |
| Buildings and improvements | 5,286,033 | 4,360,205 |
| | 6,640,781 | 5,443,757 |
| Less accumulated depreciation | (1,300,793) | (1,254,886) |
| | 5,339,988 | 4,188,871 |
| Real estate under development | 308,266 | 50,430 |
| Co-investments | 716,443 | 677,133 |
| | 6,364,697 | 4,916,434 |
| Cash and cash equivalents-unrestricted | 19,918 | 18,491 |
| Cash and cash equivalents-restricted | 28,753 | 35,275 |
| Marketable securities | 100,348 | 90,084 |
| Notes and other receivables | 36,105 | 68,255 |
| Prepaid expenses and other assets | 54,024 | 33,781 |
| Deferred charges, net | 29,197 | 24,519 |
| Total assets | \$6,633,042 | \$5,186,839 |
| Liabilities and Equity | | |
| Mortgage notes payable | \$1,408,232 | \$1,404,080 |
| Unsecured debt | 1,410,162 | 1,410,023 |
| Lines of credit | 135,903 | 219,421 |
| Accounts payable and accrued liabilities | 83,470 | 67,183 |
| Construction payable | 7,671 | 8,047 |
| Dividends payable | 1,461 | 50,627 |
| Derivative liabilities | 2,109 | 2,682 |
| Other liabilities | 22,281 | 22,189 |
| Total liabilities | 3,071,289 | 3,184,252 |
| Commitments and contingencies | | |
| Cumulative convertible Series G preferred stock | 4,349 | 4,349 |
| Equity: | | |
| Cumulative redeemable Series H preferred stock at liquidation value | 73,750 | 73,750 |
| | 4 | 4 |

Edgar Filing: ESSEX PROPERTY TRUST INC - Form 10-Q

| | | |
|--|-------------|-------------|
| Common stock, \$.0001 par value, 656,020,000 shares authorized 38,392,134 and 37,421,219 shares issued and outstanding | | |
| Additional paid-in capital | 2,505,003 | 2,345,763 |
| Distributions in excess of accumulated earnings | (498,368) | (474,426) |
| Accumulated other comprehensive loss, net | (56,395) | (60,472) |
| Total stockholders' equity | 2,023,994 | 1,884,619 |
| Noncontrolling interest | 1,533,410 | 113,619 |
| Total equity | 3,557,404 | 1,998,238 |
| Total liabilities and equity | \$6,633,042 | \$5,186,839 |

See accompanying notes to the unaudited condensed consolidated financial statements.

2

Index

ESSEX PROPERTY TRUST, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Operations and Comprehensive Income

(Unaudited)

(Dollars in thousands, except share and per share amounts)

| | Three Months Ended | |
|--|--------------------|------------|
| | March 31, | |
| | 2014 | 2013 |
| Revenues: | | |
| Rental and other property | \$ 159,017 | \$ 145,057 |
| Management and other fees | 2,628 | 2,948 |
| | 161,645 | 148,005 |
| Expenses: | | |
| Property operating, excluding real estate taxes | 36,634 | 32,253 |
| Real estate taxes | 15,339 | 14,073 |
| Depreciation | 50,312 | 46,787 |
| General and administrative | 7,075 | 6,239 |
| Merger expenses | 16,059 | - |
| Cost of management and other fees | 1,477 | 1,701 |
| Acquisition and dispositions costs | 975 | 387 |
| | 127,871 | 101,440 |
| Earnings from operations | 33,774 | 46,565 |
| Interest expense before amortization | (26,055) | (25,211) |
| Amortization expense | (2,986) | (2,930) |
| Interest and other income | 2,879 | 5,023 |
| Equity income in co-investments | 10,526 | 4,211 |
| Gains on sale of real estate and land | 8,268 | 1,503 |
| Income from continuing operations | 26,406 | 29,161 |
| Income from discontinued operations | - | 542 |
| Net income | 26,406 | 29,703 |
| Net income attributable to noncontrolling interest | (3,126) | (3,132) |
| Net income attributable to controlling interest | 23,280 | 26,571 |
| Dividends to preferred stockholders | (1,368) | (1,368) |
| Net income available to common stockholders | \$ 21,912 | \$ 25,203 |
| Comprehensive income | \$ 30,729 | \$ 30,739 |
| Comprehensive income attributable to noncontrolling interest | (3,372) | (3,187) |
| Comprehensive income attributable to controlling interest | \$ 27,357 | \$ 27,552 |
| Per common share data: | | |
| Basic: | | |
| Income from continuing operations | \$ 0.58 | \$ 0.67 |
| Income from discontinued operations | - | 0.01 |
| Net income available to common stockholders | \$ 0.58 | \$ 0.68 |
| Weighted average number of common shares outstanding during the period | 37,685,073 | 37,003,925 |
| Diluted: | | |
| Income from continuing operations | \$ 0.58 | \$ 0.67 |

Edgar Filing: ESSEX PROPERTY TRUST INC - Form 10-Q

| | | |
|--|------------|------------|
| Income from discontinued operations | - | 0.01 |
| Net income available to common stockholders | \$0.58 | \$0.68 |
| Weighted average number of common shares outstanding during the period | 37,931,454 | 37,092,062 |
| Dividend per common share | \$1.21 | \$1.21 |

See accompanying notes to the unaudited condensed consolidated financial statements.

3

Index

ESSEX PROPERTY TRUST, INC. AND SUBSIDIARIES

Condensed Consolidated Statement of Equity for the three months ended March 31, 2014

(Unaudited)

(Dollars and shares in thousands)

| | Series H | | Common | | Additional paid-in capital | Distributions in excess of accumulated earnings | Accumulated other comprehensive loss, net | Noncontrolling Interest | Total |
|---|---------------------|-----------------|-----------------|--------|----------------------------------|---|--|----------------------------|-------------|
| | Preferred Shares | stock Amount | stock Shares | Amount | | | | | |
| Balances at December 31, 2013 | 2,950 | \$73,750 | 37,421 | \$ 4 | \$2,345,763 | \$(474,426) | \$(60,472) | \$ 113,619 | \$1,998,238 |
| Net income | - | - | - | - | - | 23,280 | - | 3,126 | 26,406 |
| Reversal of unrealized gains upon the sale of marketable securities | - | - | - | - | - | - | (402) | (25) | (427) |
| Change in fair value of derivatives and amortization of swap settlements | - | - | - | - | - | - | 2,565 | 155 | 2,720 |
| Change in fair value of marketable securities | - | - | - | - | - | - | 1,914 | 116 | 2,030 |
| Issuance of common stock under: Stock option and restricted stock plans | - | - | 13 | - | 1,769 | - | - | - | 1,769 |
| Equity distribution agreements | - | - | 958 | - | 157,596 | - | - | - | 157,596 |
| Equity based compensation costs | - | - | - | - | (125) | - | - | 673 | 548 |
| Contributions from noncontrolling interest | - | - | - | - | - | - | - | 1,419,816 | 1,419,816 |
| Distributions to noncontrolling interest | - | - | - | - | - | - | - | (3,969) | (3,969) |

| | | | | | | | | | |
|--|-------|----------|--------|------|-------------|--------------|-------------|-------------|-------------|
| Redemptions of noncontrolling interest | - | - | - | - | - | - | - | (101) | (101) |
| Common and preferred stock dividends | - | - | - | - | - | (47,222) | - | - | (47,222) |
| Balances at March 31, 2014 | 2,950 | \$73,750 | 38,392 | \$ 4 | \$2,505,003 | \$(498,368) | \$(56,395) | \$1,533,410 | \$3,557,404 |

See accompanying notes to the unaudited condensed consolidated financial statements.

Index

ESSEX PROPERTY TRUST, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows

(Unaudited)

(Dollars in thousands)

| | Three Months Ended March 31, | |
|---|---------------------------------|-----------|
| | 2014 | 2013 |
| Cash flows from operating activities: | | |
| Net income | \$26,406 | \$29,703 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Gain on sale of marketable securities | (427) | (1,767) |
| Company's share of gain on the sales of co-investment | (3,213) | - |
| Gain on the sales of real estate and land | (8,268) | (1,503) |
| Noncash merger expense | 3,750 | - |
| Co-investments, net | (6,695) | (391) |
| Amortization expense | 2,986 | 2,930 |
| Amortization of discount on notes receivables | - | (844) |
| Amortization of discount on marketable securities | (1,938) | (1,377) |
| Depreciation | 50,312 | 47,144 |
| Equity-based compensation | 1,233 | 1,132 |
| Changes in operating assets and liabilities: | | |
| Prepaid expenses and other assets | 2,787 | 1,764 |
| Accounts payable and accrued liabilities | 15,918 | 8,443 |
| Other liabilities | 92 | 458 |
| Net cash provided by operating activities | 82,943 | 85,692 |
| Cash flows from investing activities: | | |
| Additions to real estate: | | |
| Acquisitions of real estate | (33,825) | (175,950) |
| Improvements to recent acquisitions | (1,960) | (2,601) |
| Redevelopment | (6,408) | (6,573) |
| Revenue generating capital expenditures | (3,873) | (304) |
| Lessor required capital expenditures | (4,321) | (768) |
| Non-revenue generating capital expenditures | (4,416) | (4,019) |
| Acquisitions of and additions to real estate under development | (11,919) | (3,332) |
| Dispositions of real estate | 14,123 | 9,051 |
| Changes in restricted cash and deposits | 2,512 | 19,980 |
| Purchases of marketable securities | (10,340) | (6,541) |
| Sales and maturities of marketable securities | 4,016 | 20,335 |
| Collections of notes and other receivables | 35,500 | 52,473 |
| Contributions to co-investments | (39,679) | (45,518) |
| Distributions from co-investments | 8,951 | 38,030 |
| Net cash used in investing activities | (51,639) | (105,737) |
| Cash flows from financing activities: | | |
| Borrowings under debt agreements | 233,780 | 235,282 |
| Repayment of debt | (312,585) | (279,854) |
| Payment of loan fees | (9,294) | (716) |
| Equity related issuance cost | (92) | (225) |
| Net proceeds from stock options exercised | 1,176 | 1,367 |
| Net proceeds from issuance of common stock | 157,596 | 122,905 |

Edgar Filing: ESSEX PROPERTY TRUST INC - Form 10-Q

| | | |
|---|-----------|-----------|
| Distributions to noncontrolling interest | (3,969) | (3,995) |
| Redemption of noncontrolling interest | (101) | (1,329) |
| Common and preferred stock dividends paid | (96,388) | (41,152) |
| Net cash (used in) provided by financing activities | (29,877) | 32,283 |
| Net increase in cash and cash equivalents | 1,427 | 12,238 |
| Cash and cash equivalents at beginning of year | 18,491 | 18,606 |
| Cash and cash equivalents at end of period | \$ 19,918 | \$ 30,844 |

(Continued)

5

Index

ESSEX PROPERTY TRUST, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows

(Unaudited)

(Dollars in thousands)

| | 2014 | 2013 |
|--|-------------|----------|
| Supplemental disclosure of cash flow information: | | |
| Cash paid for interest, net of \$3.1 million, and \$3.7 million capitalized in 2014 and 2013, respectively | \$26,447 | \$23,863 |
| Supplemental disclosure of noncash investing and financing activities: | | |
| Issuance of Operating Partnership units for contributed properties | \$1,419,816 | \$- |
| Transfer from real estate under development to rental properties | \$3,070 | \$67 |
| Transfer from real estate under development to co-investments | \$3,125 | \$- |
| Change in fair value of derivative liabilities | \$631 | \$570 |
| Change in fair value of marketable securities | \$1,575 | \$1,629 |

See accompanying notes to the unaudited condensed consolidated financial statements

6

Index

ESSEX PORTFOLIO, L.P. AND SUBSIDIARIES

Condensed Consolidated Balance Sheets

(Unaudited)

(Dollars in thousands, except unit amounts)

| | March 31, 2014 | December 31, 2013 |
|--|-------------------|-------------------------|
| <u>ASSETS</u> | | |
| Real estate: | | |
| Rental properties: | | |
| Land and land improvements | \$1,354,748 | \$1,083,552 |
| Buildings and improvements | 5,286,033 | 4,360,205 |
| | 6,640,781 | 5,443,757 |
| Less accumulated depreciation | (1,300,793) | (1,254,886) |
| | 5,339,988 | 4,188,871 |
| Real estate under development | 308,266 | 50,430 |
| Co-investments | 716,443 | 677,133 |
| | 6,364,697 | 4,916,434 |
| Cash and cash equivalents-unrestricted | 19,918 | 18,491 |
| Cash and cash equivalents-restricted | 28,753 | 35,275 |
| Marketable securities | 100,348 | 90,084 |
| Notes and other receivables | 36,105 | 68,255 |
| Prepaid expenses and other assets | 54,024 | 33,781 |
| Deferred charges, net | 29,197 | 24,519 |
| Total assets | \$6,633,042 | \$5,186,839 |
| <u>LIABILITIES AND CAPITAL</u> | | |
| Mortgage notes payable | \$1,408,232 | \$1,404,080 |
| Unsecured debt | 1,410,162 | 1,410,023 |
| Lines of credit | 135,903 | 219,421 |
| Accounts payable and accrued liabilities | 83,470 | 67,183 |
| Construction payable | 7,671 | 8,047 |
| Distributions payable | 1,461 | 50,627 |
| Derivative liabilities | 2,109 | 2,682 |
| Other liabilities | 22,281 | 22,189 |
| Total liabilities | 3,071,289 | 3,184,252 |
| Commitments and contingencies | | |
| Cumulative convertible Series G preferred interest (liquidation value of \$4,456) | 4,349 | 4,349 |
| Capital: | | |
| General Partner: | | |
| Common equity (38,392,134 and 37,421,219 units issued and outstanding at March 31, 2014 and December 31, 2013, respectively) | 2,009,181 | 1,873,882 |
| Series H Preferred interest (liquidation value of \$73,750) | 71,209 | 71,209 |
| | 2,080,390 | 1,945,091 |

Edgar Filing: ESSEX PROPERTY TRUST INC - Form 10-Q

Limited Partners:

| | | |
|---|-------------|-------------|
| Common equity (10,736,550 and 2,149,802 units issued and outstanding at March 31, 2014 and December 31, 2013, respectively) | 1,465,127 | 45,957 |
| Accumulated other comprehensive loss | (54,617) | (58,940) |
| Total partners' capital | 3,490,900 | 1,932,108 |
| Noncontrolling interest | 66,504 | 66,130 |
| Total capital | 3,557,404 | 1,998,238 |
| | | |
| Total liabilities and capital | \$6,633,042 | \$5,186,839 |

See accompanying notes to the unaudited condensed consolidated financial statements

7

Index

ESSEX PORTFOLIO, L.P. AND SUBSIDIARIES

Condensed Consolidated Statements of Operations and Comprehensive Income

(Unaudited)

(Dollars in thousands, except unit and per unit amounts)

| | Three Months Ended | |
|---|--------------------|------------|
| | March 31, | |
| | 2014 | 2013 |
| Revenues: | | |
| Rental and other property | \$ 159,017 | \$ 145,057 |
| Management and other fees | 2,628 | 2,948 |
| | 161,645 | 148,005 |
| Expenses: | | |
| Property operating, excluding real estate taxes | 36,634 | 32,253 |
| Real estate taxes | 15,339 | 14,073 |
| Depreciation | 50,312 | 46,787 |
| General and administrative | 7,075 | 6,239 |
| Merger expenses | 16,059 | - |
| Cost of management and other fees | 1,477 | 1,701 |
| Acquisition and dispositions costs | 975 | 387 |
| | 127,871 | 101,440 |
| Earnings from operations | 33,774 | 46,565 |
| Interest expense before amortization | (26,055) | (25,211) |
| Amortization expense | (2,986) | (2,930) |
| Interest and other income | 2,879 | 5,023 |
| Equity income in co-investments | 10,526 | 4,211 |
| Gains on sale of real estate and land | 8,268 | 1,503 |
| Income from continuing operations | 26,406 | 29,161 |
| Income from discontinued operations | - | 542 |
| Net income | 26,406 | 29,703 |
| Net income attributable to noncontrolling interest | (1,709) | (1,631) |
| Net income attributable to controlling interest | 24,697 | 28,072 |
| Preferred interest distributions | (1,368) | (1,368) |
| Net income available to common unitholders | \$ 23,329 | \$ 26,704 |
| Comprehensive income | \$ 30,729 | \$ 30,739 |
| Comprehensive income attributable to noncontrolling interest | (1,709) | (1,631) |
| Comprehensive income attributable to controlling interest | \$ 29,020 | \$ 29,108 |
| Per common unit data: | | |
| Basic: | | |
| Income from continuing operations | \$ 0.58 | \$ 0.67 |
| Income from discontinued operations | - | 0.01 |
| Net income available to common unitholders | \$ 0.58 | \$ 0.68 |
| Weighted average number of common units outstanding during the period | 39,957,252 | 39,083,371 |
| Diluted: | | |
| Income from continuing operations | \$ 0.58 | \$ 0.67 |

Edgar Filing: ESSEX PROPERTY TRUST INC - Form 10-Q

| | | |
|---|------------|------------|
| Income from discontinued operations | - | 0.01 |
| Net income available to common unitholders | \$0.58 | \$0.68 |
| Weighted average number of common units outstanding during the period | 40,203,633 | 39,171,508 |
| Distribution per common unit | \$1.21 | \$1.21 |

See accompanying notes to the unaudited condensed consolidated financial statements

8

Index

ESSEX PORTFOLIO, L.P. AND SUBSIDIARIES

Condensed Consolidated Statement of Capital for the three months ended March 31, 2014

(Unaudited)

(Dollars and units in thousands)

| | General Partner | | Preferred Equity | Limited Partners | | Accumulated other comprehensive (loss) income | Noncontrolling Interest | Total |
|---|-----------------|-------------|---------------------|------------------|-------------|---|----------------------------|-------------|
| | Common Equity | | | Common Equity | | | | |
| | Units | Amount | Amount | Units | Amount | | | |
| Balances at December 31, 2013 | 37,421 | \$1,873,882 | 71,209 | 2,150 | \$45,957 | \$ (58,940) | \$ 66,130 | \$1,998,238 |
| Comprehensive income: | | | | | | | | |
| Net income | - | 21,912 | 1,368 | - | 1,417 | - | 1,709 | 26,406 |
| Reversal of unrealized gains upon the sale of marketable securities | - | - | - | - | - | (427) | - | (427) |
| Change in fair value of derivatives and amortization of swap settlements | - | - | - | - | - | 2,720 | - | 2,720 |
| Change in fair value of marketable securities | - | - | - | - | - | 2,030 | - | 2,030 |
| Issuance of common units under: | | | | | | | | |
| Stock and unit based compensation | 13 | 1,769 | - | - | - | - | - | 1,769 |
| Sale of common stock by general partner | 958 | 157,596 | - | - | - | - | - | 157,596 |
| Equity based compensation costs | | (125) | - | 26 | 673 | - | - | 548 |
| Contributions from noncontrolling interest | - | - | - | 8,561 | 1,419,816 | - | - | 1,419,816 |
| Distributions to noncontrolling interest | - | - | - | - | - | - | (1,335) | (1,335) |
| Redemptions of noncontrolling interest | - | - | - | - | (101) | - | - | (101) |
| Distributions declared | - | (45,853) | (1,368) | - | (2,635) | - | - | (49,856) |
| Balances at March 31, 2014 | 38,392 | \$2,009,181 | \$71,209 | 10,737 | \$1,465,127 | \$ (54,617) | \$ 66,504 | \$3,557,404 |

See accompanying notes to the unaudited condensed consolidated financial statements
9

Index

ESSEX PORTFOLIO, L.P. AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows

(Unaudited)

(Dollars in thousands)

| | Three Months Ended March 31, | |
|---|---------------------------------|-----------|
| | 2014 | 2013 |
| Cash flows from operating activities: | | |
| Net income | \$26,406 | \$29,703 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Gain on sale of marketable securities | (427) | (1,767) |
| Company's share of gain on the sales of co-investment | (3,213) | - |
| Gain on the sales of real estate and land | (8,268) | (1,503) |
| Noncash merger expense | 3,750 | - |
| Co-investments, net | (6,695) | (391) |
| Amortization expense | 2,986 | 2,930 |
| Amortization of discount on notes receivables | - | (844) |
| Amortization of discount on marketable securities | (1,938) | (1,377) |
| Depreciation | 50,312 | 47,144 |
| Equity-based compensation | 1,233 | 1,132 |
| Changes in operating assets and liabilities: | | |
| Prepaid expenses and other assets | 2,787 | 1,764 |
| Accounts payable and accrued liabilities | 15,918 | 8,443 |
| Other liabilities | 92 | 458 |
| Net cash provided by operating activities | 82,943 | 85,692 |
| Cash flows from investing activities: | | |
| Additions to real estate: | | |
| Acquisitions of real estate | (33,825) | (175,950) |
| Improvements to recent acquisitions | (1,960) | (2,601) |
| Redevelopment | (6,408) | (6,573) |
| Revenue generating capital expenditures | (3,873) | (304) |
| Lessor required capital expenditures | (4,321) | (768) |
| Non-revenue generating capital expenditures | (4,416) | (4,019) |
| Acquisitions of and additions to real estate under development | (11,919) | (3,332) |
| Dispositions of real estate | 14,123 | 9,051 |
| Changes in restricted cash and deposits | 2,512 | 19,980 |
| Purchases of marketable securities | (10,340) | (6,541) |
| Sales and maturities of marketable securities | 4,016 | 20,335 |
| Collections of notes and other receivables | 35,500 | 52,473 |
| Contributions to co-investments | (39,679) | (45,518) |
| Distributions from co-investments | 8,951 | 38,030 |
| Net cash used in investing activities | (51,639) | (105,737) |
| Cash flows from financing activities: | | |
| Borrowings under debt agreements | 233,780 | 235,282 |
| Repayment of debt | (312,585) | (279,854) |
| Payment of loan fees | (9,294) | (716) |
| Equity related issuance cost | (92) | (225) |
| Net proceeds from stock options exercised | 1,176 | 1,367 |
| Net proceeds from issuance of common units | 157,596 | 122,905 |

Edgar Filing: ESSEX PROPERTY TRUST INC - Form 10-Q

| | | |
|---|-----------|-----------|
| Distributions to noncontrolling interest | (1,335) | (1,323) |
| Redemption of noncontrolling interest | (101) | (1,329) |
| Common units and preferred units and preferred interests distributions paid | (99,022) | (43,824) |
| Net cash (used in) provided by financing activities | (29,877) | 32,283 |
| Net increase in cash and cash equivalents | 1,427 | 12,238 |
| Cash and cash equivalents at beginning of year | 18,491 | 18,606 |
| Cash and cash equivalents at end of period | \$ 19,918 | \$ 30,844 |

(Continued)

10

Index

ESSEX PORTFOLIO, L.P. AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows

(Unaudited)

(Dollars in thousands)

| | 2014 | 2013 |
|--|-------------|----------|
| Supplemental disclosure of cash flow information: | | |
| Cash paid for interest, net of \$3.1 million, and \$3.7 million capitalized in 2014 and 2013, respectively | \$26,447 | \$23,863 |
| Supplemental disclosure of noncash investing and financing activities: | | |
| Issuance of Operating Partnership units for contributed properties | \$1,419,816 | \$- |
| Transfer from real estate under development to rental properties | \$3,070 | \$67 |
| Transfer from real estate under development to co-investments | \$3,125 | \$- |
| Change in fair value of derivative liabilities | \$631 | \$570 |
| Change in fair value of marketable securities | \$1,575 | \$1,629 |

See accompanying notes to the unaudited condensed consolidated financial statements

11

Index

ESSEX PROPERTY TRUST, INC. AND SUBSIDIARIES

ESSEX PORTFOLIO L.P. SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2014 and 2013

(Unaudited)

(1) Organization and Basis of Presentation

The accompanying unaudited condensed consolidated financial statements present the accounts of Essex Property Trust, Inc. (“Essex” or the “Company”), which include the accounts of the Company and Essex Portfolio, L.P. and subsidiaries (the “Operating Partnership,” which holds the operating assets of the Company), prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) for interim financial information and in accordance with the instructions to Form 10-Q. In the opinion of management, all adjustments necessary for a fair presentation of the financial position, results of operations and cash flows for the periods presented have been included and are normal and recurring in nature. These unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements included in the Company's annual report on Form 10-K for the year ended December 31, 2013.

All significant intercompany balances and transactions have been eliminated in the condensed consolidated financial statements. Certain reclassifications have been made to conform to the current year's presentation. Such reclassification had no effect on previously reported financial statements.

On April 1, 2014, Essex completed the merger with BRE Properties, Inc. (“BRE”). In connection with the closing of the merger, (1) BRE merged into a wholly owned subsidiary of Essex, and (2) each outstanding share of BRE common stock was converted into (i) 0.2971 shares (the “Stock Consideration”) of Essex common stock, and (ii) \$7.18 in cash, (the “Cash Consideration”), plus cash in lieu of fractional shares for total consideration of approximately \$4.3 billion. The Cash Consideration was adjusted as a result of the authorization and declaration of a special distribution to the stockholders of BRE of \$5.15 per share of BRE common stock payable to BRE stockholders of record as of the close of business on March 31, 2014 (the “Special Dividend”). The Special Dividend is payable as a result of the closing of the sale of certain interests in assets of BRE to certain parties designated by Essex, which closed on March 31, 2014. Pursuant to the terms of the merger agreement, the amounts payable as a Special Dividend reduced the Cash Consideration of \$12.33 payable by Essex in the merger to \$7.18 per share of BRE common stock.

Essex issued approximately 23.1 million shares of Essex common stock as Stock Consideration in the merger. For purchase accounting, the value of the common stock issued by Essex upon the consummation of the merger was determined based on the closing price of BRE's common stock on the closing date of the merger. As a result of Essex being admitted to the S&P 500 on the same date as the closing of the merger, Essex's common stock price experienced significantly higher than usual trading volume and the closing price of \$174 per share was significantly higher than its volume-weighted average trading price for the days before and after April 1, 2014. BRE's common stock did not experience the same proportionate increase in common stock price leading up to April 1, 2014. As a result, given that a substantial component of the purchase price is an exchange of equity instruments, Essex used the closing price of BRE's common stock on April 1, 2014 of \$61 per share, less the Cash Consideration, as the fair value of the Stock Consideration. The net assets and results of operations of BRE will be included in our condensed consolidated financial statements beginning April 1, 2014, our second quarter of 2014.

On March 31, 2014, BRE contributed 14 properties valued at approximately \$1.4 billion to Essex for approximately 8.6 million Operating Partnership units (“OP units”). The OP units were subsequently retired by the Company on April 1, 2014. The purpose of this transaction was tax efficiency.

The unaudited condensed consolidated financial statements for the three months ended March 31, 2014 and 2013 include the accounts of the Company and the Operating Partnership. Essex is the sole general partner in the Operating Partnership, and excluding the 8.6 million OP units issued on March 31, 2014 and retired on April 1, 2014, held a 94.5% general partnership interest as of March 31, 2014. Total Operating Partnership units outstanding, excluding the March 31, 2014 transaction, were 2,176,222 and 2,149,802 as of March 31, 2014 and December 31, 2013, respectively, and the redemption value of the units, based on the closing price of the Company's common stock totaled \$370.1 million and \$308.5 million, as of March 31, 2014 and December 31, 2013, respectively.

12

Index

ESSEX PROPERTY TRUST, INC. AND SUBSIDIARIES

ESSEX PORTFOLIO L.P. SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2014 and 2013

(Unaudited)

As of March 31, 2014, and prior to the merger with BRE, the Company owned or had ownership interests in 176 apartment communities, aggregating 37,569 units, excluding the Company's ownership in preferred interest co-investments, (collectively, the "Communities", and individually, a "Community"), four commercial buildings and thirteen active development projects (collectively, the "Portfolio"). The Communities are located in Southern California (Los Angeles, Orange, Riverside, San Diego, Santa Barbara, and Ventura counties), Northern California (the San Francisco Bay Area) and the Seattle metropolitan area.

Marketable Securities

The Company reports its available for sale securities at fair value, based on quoted market prices (Level 2 for the unsecured bonds and Level 1 for the common stock and investment funds, as defined by the Financial Accounting Standards Board ("FASB") standard for fair value measurements, and any unrealized gain or loss is recorded as other comprehensive income (loss). Realized gains and losses, interest and dividend income, and amortization of purchase discounts are included in interest and other income on the condensed consolidated statement of operations and comprehensive income.

As of March 31, 2014 and December 31, 2013, marketable securities consisted primarily of investment-grade unsecured bonds, common stock, investments in mortgage backed securities and investment funds that invest in U.S. treasury or agency securities. As of March 31, 2014 and December 31, 2013, the Company classified its investments in mortgage backed securities, which mature in November 2019 and September 2020, as held to maturity, and accordingly, these securities are stated at their amortized cost. As of March 31, 2014 and December 31, 2013 marketable securities consist of the following (\$ in thousands):

| | March 31, 2014 | | |
|----------------------------------|--------------------|---------------------|-----------|
| | Cost/ Amortized | Gross Unrealized | Carrying |
| | Cost | Gain (Loss) | Value |
| Available for sale: | | | |
| Investment-grade unsecured bonds | \$11,772 | \$ 96 | \$11,868 |
| Investment funds - US treasuries | 5,017 | 5 | 5,022 |
| Common stock | 22,103 | 710 | 22,813 |
| Held to maturity: | | | |
| Mortgage backed securities | 60,645 | - | 60,645 |
| Total | \$99,537 | \$ 811 | \$100,348 |
| | | | |
| | December 31, 2013 | | |
| | Cost/ Amortized | Gross Unrealized | Carrying |
| | Cost | Gain (Loss) | Value |
| Available for sale: | | | |
| Investment-grade unsecured bonds | \$15,446 | \$ 509 | \$15,955 |
| Investment funds - US treasuries | 3,675 | 3 | 3,678 |

Edgar Filing: ESSEX PROPERTY TRUST INC - Form 10-Q

| | | | |
|----------------------------|----------|-----------|----------|
| Common stock | 13,104 | (1,304) | 11,800 |
| Held to maturity: | | | |
| Mortgage backed securities | 58,651 | - | 58,651 |
| Total | \$90,876 | \$ (792) | \$90,084 |

The Company uses the specific identification method to determine the cost basis of a security sold and to reclassify amounts from accumulated other comprehensive income for securities sold. For the three months ended March 31, 2014, and 2013, the proceeds from sales of available for sale securities totaled \$4.0 million and \$20.3 million, respectively, which resulted in gains of \$0.4 million and \$1.8 million, respectively.

13

Index

ESSEX PROPERTY TRUST, INC. AND SUBSIDIARIES

ESSEX PORTFOLIO L.P. SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2014 and 2013

(Unaudited)

Variable Interest Entities

The Company consolidates 19 DownREIT limited partnerships (comprising twelve communities) since the Company is the primary beneficiary of these variable interest entities (“VIEs”). Total DownREIT units outstanding were 1,007,879 for both as of March 31, 2014 and December 31, 2013, and the redemption value of the units, based on the closing price of the Company’s common stock totaled \$171.4 million and \$144.6 million, as of March 31, 2014 and December 31, 2013, respectively. The consolidated total assets and liabilities related to these VIEs, net of intercompany eliminations, were approximately \$233.4 million and \$218.9 million, respectively, as of March 31, 2014 and \$194.9 million and \$178.3 million, respectively, as of December 31, 2013. Interest holders in VIEs consolidated by the Company are allocated income equal to the cash payments made to those interest holders. The remaining results of operations are allocated to the Company. As of March 31, 2014 and December 31, 2013, the Company did not have any other VIEs of which it was deemed to be the primary beneficiary.

Equity Based Compensation

The Company accounts for equity based compensation using the fair value method of accounting. The estimated fair value of stock options granted by the Company is being amortized over the vesting period of the stock options. The estimated grant date fair values of the long term incentive plan units (discussed in Note 13, “Equity Based Compensation Plans,” in the Company’s Form 10-K for the year ended December 31, 2013) are being amortized over the expected service periods.

Stock-based compensation expense for options and restricted stock totaled \$0.6 million for the three months ended March 31, 2014 and 2013. The intrinsic value of the stock options exercised during the three months ended March 31, 2014 and 2013 totaled \$0.6 million and \$0.9 million, respectively. As of March 31, 2014, the intrinsic value of the stock options outstanding and fully vested totaled \$21.1 million. As of March 31, 2014, total unrecognized compensation cost related to unvested share-based compensation granted under the stock option and restricted stock plans totaled \$6.1 million. The cost is expected to be recognized over a weighted-average period of 1 to 5 years for the stock option plans and is expected to be recognized straight-line over a period of 1 to 7 years for the restricted stock awards.

The Company has adopted an incentive program involving the issuance of Series Z-1 Incentive Units of limited partnership interest in the Operating Partnership. The Operating Partnership also issued 50,500 units under the 2014 Long-Term Incentive Plan Award agreements in December 2013. Pursuant to the 2014 Long-Term Incentive Plan Awards, each recipient was initially granted a number of 2014 Long-Term Incentive Plan Units (the “2014 LTIP Units”), 90% of which are subject to performance-based vesting, and 10% of which are subject to service-based vesting based on continued employment. One-third of the performance-based vesting of the 2014 LTIP Units initially granted will be eligible to be earned by recipients based on Essex’s absolute total stockholder return and two-thirds will be eligible to be earned based on Essex’s relative total stockholder return, in each case, during a one-year performance period beginning on the initial grant date of the awards.

Stock-based compensation expense for Z-1 Units and 2014 LTIP Units totaled \$0.6 million and \$0.5 million for the three months ended March 31, 2014 and 2013, respectively. As of March 31, 2014, the intrinsic value of the Z-1 Units and 2014 LTIP Units subject to future vesting totaled \$22.4 million. As of March 31, 2014, total unrecognized compensation cost related to Z-1 Units and 2014 LTIP Units subject to future vesting totaled \$7.6 million. The

unamortized cost is expected to be recognized over 6 years subject to the achievement of the stated performance criteria.

Fair Value of Financial Instruments

Management believes that the carrying amounts of outstanding lines of credit, notes and other receivables approximate fair value as of March 31, 2014 and December 31, 2013, because interest rates, yields and other terms for these instruments are consistent with yields and other terms currently available for similar instruments. Management has estimated that the fair value of the Company's \$2.29 billion of fixed rate debt, including unsecured bonds, at March 31, 2014 is approximately \$2.42 billion and the fair value of the Company's \$527.6 million of variable rate debt, excluding borrowings under the lines of credit, at March 31, 2014 is \$500.0 million based on the terms of existing mortgage notes payable, unsecured bonds and variable rate demand notes compared to those available in the marketplace. Management believes that the carrying amounts of cash and cash equivalents, restricted cash, accounts payable and accrued liabilities, construction payables, other liabilities and dividends payable approximate fair value as of March 31, 2014 due to the short-term maturity of these instruments. Marketable securities, except mortgage backed securities, and derivatives are carried at fair value as of March 31, 2014.

14

Index

ESSEX PROPERTY TRUST, INC. AND SUBSIDIARIES

ESSEX PORTFOLIO L.P. SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2014 and 2013

(Unaudited)

At March 31, 2014, the Company's investments in mortgage backed securities had a carrying value of \$60.6 million and the Company estimated the fair value to be approximately \$89.4 million. At December 31, 2013, the Company's investments in mortgage backed securities had a carrying value of \$58.7 million and the Company estimated the fair value to be approximately \$86.2 million. The Company determines the fair value of the mortgage backed securities based on unobservable inputs (level 3 of the fair value hierarchy) considering the assumptions that market participants would make in valuing these securities. Assumptions such as estimated default rates and discount rates are used to determine expected, discounted cash flows to estimate the fair value.

Capitalization of Costs

The Company's capitalized internal costs related to development and redevelopment projects totaled \$1.7 million and \$1.6 million during the three months ended March 31, 2014 and 2013, respectively, most of which relates to development projects. These totals include capitalized salaries of \$0.9 million and \$0.6 million for the three months ended March 31, 2014 and 2013, respectively. The Company capitalizes leasing commissions associated with the lease-up of a development community and amortizes the costs over the life of the leases. The amounts capitalized are immaterial for all periods presented.

Co-investments

The Company owns investments in joint ventures ("co-investments") in which it has significant influence, but its ownership interest does not meet the criteria for consolidation in accordance with the accounting standards. Therefore, the Company accounts for these investments using the equity method of accounting. Under the equity method of accounting, the investment is carried at the cost of assets contributed, plus the Company's equity in earnings less distributions received and the Company's share of losses. The significant accounting policies of the Company's co-investment entities are consistent with those of the Company in all material respects. For preferred equity investments, the Company recognizes its preferred interest in equity income in co-investments.

Upon the acquisition of a controlling interest of a co-investment, the co-investment entity is consolidated and a gain or loss is recognized upon the remeasurement of co-investments in the consolidated statement of operations equal to the amount by which the fair value of the co-investment interest the Company previously owned exceeds its carrying value. A majority of the co-investments, excluding the preferred equity investments, compensate the Company for its asset management services and may provide promote distributions if certain financial return benchmarks are achieved. Asset management fees are recognized when earned, and promote fees are recognized when the earnings events have occurred and the amount is determinable and collectible. Any promote fees are reflected in equity income (loss) from co-investments.

Changes in Accumulated Other Comprehensive Loss, Net by Component

Essex Property Trust, Inc.

| Change in fair | Unrealized gains/(losses) on |
|-------------------|------------------------------------|
|-------------------|------------------------------------|

Edgar Filing: ESSEX PROPERTY TRUST INC - Form 10-Q

| | value and amortization of derivatives | available for sale securities | Total |
|--|--|-------------------------------------|--------------|
| Balance at December 31, 2013 | \$ (59,724 |) \$ (748 |) \$(60,472) |
| Other comprehensive income (loss) before reclassification | 472 | 1,914 | 2,386 |
| Amounts reclassified from accumulated other comprehensive loss | 2,093 | (402 |) 1,691 |
| Net other comprehensive income (loss) | 2,565 | 1,512 | 4,077 |
| Balance at March 31, 2014 | \$ (57,159 |) \$ 764 | \$(56,395) |

15

Index

ESSEX PROPERTY TRUST, INC. AND SUBSIDIARIES

ESSEX PORTFOLIO L.P. SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2014 and 2013

(Unaudited)

Essex Portfolio, L.P.

| | Change in fair value and amortization of derivatives | Unrealized gains/(losses) on available for sale securities | Total |
|--|---|---|------------|
| Balance at December 31, 2013 | \$ (58,148) | \$ (792) | \$(58,940) |
| Other comprehensive income (loss) before reclassification | 627 | 2,030 | 2,657 |
| Amounts reclassified from accumulated other comprehensive loss | 2,093 | (427) | 1,666 |
| Net other comprehensive income (loss) | 2,720 | 1,603 | 4,323 |
| Balance at March 31, 2014 | \$ (55,428) | \$ 811 | \$(54,617) |

Amounts reclassified from accumulated other comprehensive loss in connection with derivatives are recorded in interest expense before amortization on the condensed consolidated statement of operations and comprehensive income. Realized gains and losses on available for sale securities are included in interest and other income on the condensed consolidated statement of operations and comprehensive income.

Accounting Estimates

The preparation of condensed consolidated financial statements, in accordance with U.S. generally accepted accounting principles, requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosures of contingent assets and liabilities. On an on-going basis, the Company evaluates its estimates, including those related to acquiring, developing and assessing the carrying values of its real estate portfolio, its investments in and advances to joint ventures and affiliates, its notes receivables and its qualification as a Real Estate Investment Trust (“REIT”). The Company bases its estimates on historical experience, current market conditions, and on various other assumptions that are believed to be reasonable under the circumstances. Actual results may vary from those estimates and those estimates could be different under different assumptions or conditions.

Discontinued Operations

In April 2014, the Financial Accounting Standards Board (“FASB”) issued ASU, No. 2014-018, Presentation of Financial Statements, Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity. ASU 2014-018 changes the requirements for reporting discontinued operation under Subtopic 205-20, Presentation of Financial Statements—Discontinued Operations. The amendment updates the definition of discontinued operation and defines discontinued operations to be those disposals of components of an entity that represent a strategic shift that has (or will have) a major effect on an entity’s operations and financial results. This ASU is effective for disposals of components of an entity that occur within annual periods beginning on or after December 15, 2014 with early adoption permitted, but only for disposal that have not been reported in financial statements previously issued.

The Company adopted ASU 2014-018 in its first quarter of 2014. In January 2014, Essex sold Vista Capri North, a 106 unit community located in San Diego, CA for \$14.4 million. The total gain on sale was \$7.9 million. The Company determined that the disposal was not a discontinued operation in accordance with ASU 2014-018. The gain is recorded in gains on sale of real estate and land in the condensed consolidated statements of operations and comprehensive income.

BRE Merger

As previously discussed in Note 1, the merger with BRE closed on April 1, 2014 and 14 of the BRE properties were acquired on March 31, 2013. The preliminary fair value of the assets acquired on March 31, 2014 in exchange for \$1.4 billion of OP units was substantially all attributable to rental properties which included land, buildings and improvements, and real estate under development and approximately \$19 million attributable to acquired in-place lease value which is classified within prepaid expenses and other assets in the accompanying condensed consolidated balance sheets. With regards to the BRE merger that closed on April 1, 2014, a summary of the preliminary fair value of the assets and liabilities acquired on April 1, 2014 in exchange for the total consideration of approximately \$4.3 billion were as follows (includes the 14 properties acquired on March 31, 2014 as the OP units issued were retired on April 1, 2014) (in millions):

16

Index

ESSEX PROPERTY TRUST, INC. AND SUBSIDIARIES

ESSEX PORTFOLIO L.P. SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2014 and 2013

(Unaudited)

| | |
|---|----------|
| Rental properties, excluding co-investments | \$ 5,808 |
| Co-investments | 206 |
| In-place lease value | 97 |
| Other assets | 96 |
| Secured and unsecured debt | (1,736) |
| Other liabilities | (129) |
| | \$4,342 |

The initial purchase accounting is based on management's preliminary assessment, which may differ when final information becomes available. Subsequent adjustments made to the initial purchase accounting, if any, are made within the measurement period, which typically does not exceed one year.

The unaudited pro forma financial information set forth below is based on Essex's historical condensed consolidated statement of operations and comprehensive income for the quarters ended March 31, 2014 and March 31, 2013, adjusted to give effect to the merger with BRE including the 14 BRE properties contributed on March 31, 2014, as if they occurred on January 1, 2013. The pro forma adjustments primarily relate to merger expenses, depreciation expense on acquired buildings and improvements, amortization of acquired intangibles, and estimated interest expense related to assumed debt.

Essex Property Trust, Inc.

| | | |
|---|--|-------------|
| | Pro forma (unaudited) three months ended March 31 (in thousands, except per share data) | |
| | 2014 | 2013 |
| Total revenue | \$247,801 | \$228,721 |
| Net income available to common shareholders (1) (2) | \$130,506 | \$(16,956) |
| Earnings per share, diluted (1) | \$2.08 | \$(0.28) |

Essex Portfolio, L.P.

| | | |
|--|---|-------------|
| | Pro forma (unaudited) three months ended March 31 (in thousands, except per unit data) | |
| | 2014 | 2013 |
| Total revenue | \$247,801 | \$228,721 |
| Net income available to common unitholders (1) (2) | \$131,923 | \$(15,455) |
| Earnings per unit, diluted (1) | \$2.08 | \$(0.25) |

2014 supplemental pro forma net income available to common stockholders were adjusted to exclude \$16,059 of merger related costs incurred by Essex during the three-months ended March 31, 2014. 2013 supplemental pro forma net income available to common stockholders were adjusted to include these charges plus an additional approximately \$29,000 of merger expenses estimated to be incurred by Essex. 2014 and 2013 supplemental proforma earnings per share, diluted, were adjusted accordingly.

(2) 2014 supplemental pro forma net income available to common stockholders includes approximately \$105 million from discontinued operations related to the sale of three BRE properties that are non-recurring transactions.

17

Index

ESSEX PROPERTY TRUST, INC. AND SUBSIDIARIES

ESSEX PORTFOLIO L.P. SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2014 and 2013

(Unaudited)

(2) Significant Transactions During the First Quarter of 2014 and Subsequent Events

Acquisitions

In March 2014, the Company purchased Avery, a 121-unit apartment community located in Valley Village, California, for a total purchase price of \$35.0 million. In May 2014, the Company acquired Piedmont Apartments for \$76.8 million. The 396 unit community was built in 1969 and subsequently renovated in 1997 and 2005. The Company assumed a \$44.8 million mortgage loan secured by the property at a fixed rate of 5.6% for a remaining term of 3 years. The property is located in the East Bellevue submarket of Seattle.

Dispositions

In March 2014, Essex Apartment Value Fund II, L.P. ("Fund II") sold one of the two remaining communities owned by Fund II for \$23.8 million which resulted in a gain of \$11.4 million. The Company has a 28.2% ownership stake in Fund II and received a promote income allocation of \$3.8 million which is included within equity income from co-investments in the accompanying condensed consolidated statement of income for the three months ended March 31, 2014. The remaining Fund II property is expected to be sold in 2014.

Common Stock

During the first quarter of 2014, the Company issued 958,055 shares of common stock, through our equity distribution program, at an average share price of \$166.24 for proceeds of \$157.6 million, net of fees and commissions. During the second quarter of 2014 through May 8, 2014, Essex has issued 197,600 shares of common stock at an average price of \$171.62 for proceeds of \$33.7 million, net of fees and commissions.

Unsecured Bond Offering

In April 2014, the Company issued \$400 million aggregate principal amount of its 3.875% Senior Notes due 2024 (the 2024 Notes). The net proceeds from the issuance of the 2024 Notes were approximately \$394 million, after deducting the underwriters' discounts and estimated offering expenses.

18

Index

ESSEX PROPERTY TRUST, INC. AND SUBSIDIARIES

ESSEX PORTFOLIO L.P. SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2014 and 2013

(Unaudited)

(3) Co-investments

The Company has co-investments, which are accounted for under the equity method. The co-investments own, operate and develop apartment communities. The following table details the Company's co-investments (dollars in thousands):

| | March 31, 2014 | December 31, 2013 |
|---|----------------------|-------------------------|
| Membership interest in Wesco I | \$ 136,495 | \$ 142,025 |
| Membership interest in Wesco III | 38,928 | 39,073 |
| Partnership interest in Fund II | 7,235 | 4,166 |
| Membership interest in a limited liability company that owns Expo | 11,877 | 12,041 |
| Total operating co-investments | 194,535 | 197,305 |
| Membership interests in limited liability companies with CPPIB that own and are developing Epic, Connolly Station, Mosso I & II, Park 20, and The Village | 336,417 | 301,538 |
| Membership interests in limited liability companies that own and are developing The Huxley and The Dylan | 19,151 | 18,545 |
| Membership interest in a limited liability company that owns and is developing One South Market | 22,632 | 17,115 |
| Total development co-investments | 378,200 | 337,198 |
| Membership interest in Wesco II that owns a preferred equity interest in Parkmerced with a preferred return of 10.1% | 95,115 | 94,711 |
| Preferred interest in related party limited liability company that owns Sage at Cupertino with a preferred return of 9.5% | 15,955 | 15,775 |
| Preferred interest in a related party limited liability company that owns Madison Park at Anaheim with a preferred return of 9% | 13,824 | 13,824 |
| Preferred interest in related party limited liability company that owns an apartment development in Redwood City with a preferred return of 12% | 9,681 | 9,455 |
| Preferred interest in a limited liability company that owns an apartment development in San Jose with a preferred return of 12% | 9,133 | 8,865 |
| Total preferred interest investments | 143,708 | 142,630 |
| Total co-investments | \$ 716,443 | \$ 677,133 |

Index

ESSEX PROPERTY TRUST, INC. AND SUBSIDIARIES

ESSEX PORTFOLIO L.P. SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2014 and 2013

(Unaudited)

The combined summarized balance sheet and statements of operations for co-investments are as follows (dollars in thousands).

| | March 31, 2014 | December 31, 2013 |
|---|---|-------------------------|
| Balance sheets: | | |
| Rental properties and real estate under development | \$1,993,763 | \$1,953,328 |
| Other assets | 131,716 | 61,578 |
| Total assets | \$2,125,479 | \$2,014,906 |
| Debt | \$756,117 | \$667,641 |
| Other liabilities | 82,519 | 125,479 |
| Equity | 1,286,843 | 1,221,786 |
| Total liabilities and equity | \$2,125,479 | \$2,014,906 |
| Company's share of equity | \$716,443 | \$677,133 |
| ` | Three Months Ended March 31, 2014 2013 | |
| Statements of operations: | | |
| Property revenues | \$27,960 | \$27,859 |
| Property operating expenses | (11,560) | (9,828) |
| Net property operating income | 16,400 | 18,031 |
| Gain on sale of real estate | 11,369 | - |
| Interest expense | (6,023) | (6,778) |
| General and administrative | (1,388) | (1,514) |
| Equity income from co-investments | 4,759 | 4,622 |
| Depreciation and amortization | (10,693) | (11,019) |
| Net income | \$14,424 | \$3,342 |
| Company's share of net income | \$10,526 | \$4,211 |

(4) Notes and Other Receivables

Notes receivable secured by real estate and other receivables consist of the following as of March 31, 2014 and December 31, 2013 (dollars in thousands):

Edgar Filing: ESSEX PROPERTY TRUST INC - Form 10-Q

| March | December |
|-------|----------|
| 31, | 31, |
| 2014 | 2013 |

Notes receivable, secured, bearing interest at 4.0%, due December 2014 ⁽¹⁾ \$3,212