

MISSION WEST PROPERTIES INC
Form 10-Q
November 09, 2010

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 September 30, 2010

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 1-8383

Mission West Properties, Inc.
(Exact name of registrant as specified in its charter)

Maryland
(State or other jurisdiction of incorporation or
organization)

95-2635431
(I.R.S. Employer Identification No.)

10050 Bandley Drive
Cupertino, California
(Address of principal executive offices)

95014
(Zip Code)

(408) 725-0700
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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). Yes No

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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.

Large accelerated filer <input type="radio"/>	Accelerated filer <input checked="" type="checkbox"/>	Non-accelerated filer <input type="radio"/>	Smaller reporting company <input type="radio"/>
		(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).
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.

As of November 9, 2010, there were 22,028,470 shares of common stock outstanding, par value \$.001 per share.

Mission West Properties, Inc.

FORM 10-Q
FOR THE QUARTER ENDED SEPTEMBER 30, 2010

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Exhibits

Exhibit 10.16	Hartford Fixed Rate Term Loan Agreement II
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Exhibit 10.16.2	Hartford Life and Accident Insurance Company Promissory Note II
Exhibit 10.16.3	Hartford-Mission West Properties, L.P. Deed of Trust, Security Agreement and Fixture Filing II
Exhibit 10.16.4	Hartford-Mission West Properties, L.P. I Deed of Trust, Security Agreement and Fixture Filing II
Exhibit 10.16.5	Hartford Carveout Indemnity Agreement II
Exhibit 10.16.6	Hartford Environmental Indemnity Agreement II

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- Exhibit 31.1 Certification Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934
- Exhibit 31.2 Certification Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934
- Exhibit 31.3 Certification Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934
- Exhibit 32 Certification of CEO and CFO Pursuant to 18 U.S.C. § 1350, as Adopted Pursuant to § 906 of the Sarbanes-Oxley Act of 2002

PART I – Financial Information

Item 1. Condensed Consolidated Financial Statements

MISSION WEST PROPERTIES, INC.
 CONDENSED CONSOLIDATED BALANCE SHEETS
 (dollars in thousands, except share and par value amounts)

	September 30, 2010 (unaudited)	December 31, 2009
ASSETS		
Investments in real estate:		
Land	\$ 322,828	\$ 320,911
Buildings and improvements	792,956	799,649
Real estate related intangible assets	3,240	3,240
Total investments in properties	1,119,024	1,123,800
Accumulated depreciation and amortization	(219,295)	(204,153)
Assets held for sale, net of accumulated depreciation	7,629	-
Net investments in properties	907,358	919,647
Investment in unconsolidated joint venture	3,872	3,828
Net investments in real estate	911,230	923,475
Cash and cash equivalents	15,226	986
Restricted cash	89	197
Restricted investment in marketable securities	-	12,069
Deferred rent receivables	18,422	18,711
Other assets, net	33,396	30,951
Total assets	\$ 978,363	\$ 986,389
LIABILITIES AND EQUITY		
Liabilities:		
Mortgage notes payable	\$ 349,297	\$ 318,818
Mortgage note payable (related parties)	7,860	8,261
Note payable (related parties)	-	9,325
Revolving line of credit	-	14,466
Interest payable	1,664	1,573
Security deposits	4,882	4,849
Deferred rental income	5,706	6,539
Liabilities related to assets held for sale	33	-
Dividends and distributions payable	15,793	15,791
Accounts payable and accrued expenses	17,992	9,638
Total liabilities	403,227	389,260
Commitments and contingencies (Note 9)		
Equity:		
Stockholders' equity attributable to Mission West Properties, Inc.:	-	-

Preferred stock, \$.001 par value, 20,000,000 shares authorized, none issued and outstanding		
Common stock, \$.001 par value, 200,000,000 shares authorized, 22,013,070 and 21,870,211 shares issued and outstanding at September 30, 2010 and December 31, 2009	22	22
Additional paid-in capital	171,692	170,606
Distributions in excess of accumulated earnings	(29,384)	(25,784)
Total stockholders' equity attributable to Mission West Properties, Inc.	142,330	144,844
Noncontrolling interests in operating partnerships	432,806	452,285
Total equity	575,136	597,129
Total liabilities and equity	\$ 978,363	\$ 986,389

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

MISSION WEST PROPERTIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(dollars in thousands, except share and per share amounts)
(unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2010	2009	2010	2009
Operating revenues:				
Rental income	\$ 20,596	\$ 20,431	\$ 62,058	\$ 61,478
Tenant reimbursements	3,113	4,551	11,567	13,632
Other income	276	284	2,138	905
Total operating revenues	23,985	25,266	75,763	76,015
Operating expenses:				
Property operating, maintenance and real estate taxes	6,731	6,709	19,301	19,814
General and administrative	580	589	1,661	1,743
Depreciation and amortization	5,804	5,863	17,665	18,026
Total operating expenses	13,115	13,161	38,627	39,583
Operating income	10,870	12,105	37,136	36,432
Other income (expenses):				
Equity in earnings of unconsolidated joint venture	46	72	270	237
Interest and dividend income	1	93	51	1,158
Realized and unrealized gain from investment	-	4,464	4,067	4,140
Interest expense	(5,138)	(5,180)	(14,765)	(17,071)
Interest expense – related parties	(214)	(202)	(839)	(554)
Income from continuing operations	5,565	11,352	25,920	24,342
Discontinued operations:				
(Loss) from operations of property held for	(94)	(110)	(265)	(277)

sale				
Net income	5,471	11,242	25,655	24,065
Net income attributable to noncontrolling interests	(4,101)	(8,476)	(19,367)	(18,083)
Net income available to common stockholders	\$ 1,370	\$ 2,766	\$ 6,288	\$ 5,982
Net income per common share to common stockholders:				
Basic	\$ 0.06	\$ 0.13	\$ 0.29	\$ 0.28
Diluted	\$ 0.06	\$ 0.13	\$ 0.28	\$ 0.27
Weighted average shares of common stock outstanding (basic)	21,976,679	21,770,211	21,938,857	21,717,713
Weighted average shares of common stock outstanding (diluted)	22,109,391	21,902,387	22,095,602	21,858,067

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

MISSION WEST PROPERTIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(dollars in thousands)
(unaudited)

	Nine months ended September	
	2010	2009
Cash flows from operating activities:		
Net income	\$ 25,655	\$ 24,065
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	17,840	18,200
Realized and unrealized gain from restricted investment in marketable securities	(4,067)	(4,140)
Dividend income from restricted investment in marketable securities	-	(651)
Equity in earnings of unconsolidated joint venture	(270)	(237)
Distributions from unconsolidated joint venture	226	175
Interest earned on restricted cash	-	(92)
Lease termination fee related to restricted cash	10,381	10,864
Stock-based compensation expense	109	243
Other	9	-
Changes in operating assets and liabilities, net of liabilities assumed:		
Proceeds from sale of investment in marketable securities	16,211	3,646
Deferred rent receivables	289	(675)
Other assets	(2,062)	(5,157)
Interest payable	91	(26)
Security deposits	37	(246)
Deferred rental income	(833)	1,561
Accounts payable and accrued expenses	8,383	11,215
Net cash provided by operating activities	71,999	58,745
Cash flows from investing activities:		
Improvements to real estate assets	(1,699)	(156)
Restricted cash deposited into escrow	-	(500)
Restricted cash released from escrow	100	-
Purchase of real estate	(3,852)	-
Net cash used in investing activities	(5,451)	(656)
Cash flows from financing activities:		
Proceeds from mortgage note payable	40,000	-
Principal payments on mortgage notes payable	(9,521)	(9,001)
	(401)	(372)

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Principal payments on mortgage note payable (related parties)		
Proceeds from note payable (related parties)	52,963	29,641
Payments on note payable (related parties)	(62,288)	(29,641)
(Payments on) proceeds from note payable	(10,381)	15,000
Net repayments on revolving line of credit	(14,466)	(9,506)
Financing costs	(457)	-
Net proceeds from exercise of stock options	67	-
Distributions paid to noncontrolling interests	(37,956)	(42,069)
Dividends paid to common stockholders	(9,868)	(11,565)
Net cash used in financing activities	(52,308)	(57,513)
Net increase in cash and cash equivalents	14,240	576
Cash and cash equivalents, beginning of period	986	-
Cash and cash equivalents, end of period	\$ 15,226	\$ 576
Supplemental information:		
Cash paid for interest	\$ 16,818	\$ 14,841
Supplemental schedule of non-cash investing and financing activities:		
Issuance of common stock upon conversion of O.P. units	\$ 911	\$ 15,138

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

MISSION WEST PROPERTIES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(dollars in thousands, except par value and per share amounts)
(unaudited)

1. Organization and Formation of the Company

Mission West Properties, Inc. (the "Company") is a fully integrated, self-administered and self-managed real estate company that acquires and manages research and development ("R&D")/office properties in the portion of the San Francisco Bay Area commonly referred to as Silicon Valley. In July 1998, the Company purchased an approximate 12.11% of four existing limited partnerships (referred to collectively as the "operating partnerships") and obtained control of these partnerships by becoming the sole general partner in each one effective July 1, 1998 for financial accounting and reporting purposes. All limited partnership interests in the operating partnerships were converted into 59,479,633 operating partnership ("O.P.") units, which represented a limited partnership ownership interest of approximately 87.89% of the operating partnerships. The operating partnerships are the vehicles through which the Company holds its real estate investments, makes real estate acquisitions, and generally conducts its business.

On December 30, 1998, the Company was reincorporated under the laws of the State of Maryland through a merger with and into Mission West Properties, Inc. Accordingly, shares of the former company, Mission West Properties, a California corporation (no par), which were outstanding at December 30, 1998, were converted into shares of common stock, \$.001 par value per share, on a one-for-one basis.

As of September 30, 2010, the Company owned a controlling general partnership interest of 24.44%, 21.86%, 16.32% and 12.52% in Mission West Properties, L.P., Mission West Properties, L.P. I, Mission West Properties, L.P. II and Mission West Properties, L.P. III, respectively, which represents a 20.83% general partnership interest in the operating partnerships, taken as a whole, on a consolidated weighted average basis.

Through the operating partnerships, the Company owns interests in 112 R&D/office properties, all of which are located in the Silicon Valley.

The Company has elected to be taxed as a Real Estate Investment Trust ("REIT") under the Internal Revenue Code of 1986, as amended. Accordingly, no provision has been made for income taxes for the three and nine months ended September 30, 2010 and 2009.

Business Segment Information

The Company's primary business is the ownership and management of R&D/office real estate with a geographic concentration in the Silicon Valley of the San Francisco Bay Area. Accordingly, the Company has concluded it currently has a single reportable segment for the Segment Reporting Topic of the Financial Accounting Standards Board Accounting Standards Codification ("FASB ASC") 280 purposes.

2. Basis of Presentation

Principles of Consolidation and Basis of Presentation

The accompanying unaudited interim condensed consolidated financial statements of the Company have been prepared in accordance with Rule 10-01 of Regulation S-X promulgated by the Securities and Exchange Commission ("SEC") and, therefore, do not include all information and footnotes necessary for a fair presentation of financial position, results of operations and cash flows in conformity with accounting principles generally accepted in the United States of America ("GAAP"). In the opinion of the Company, however, the accompanying unaudited interim condensed consolidated financial statements contain all adjustments, consisting only of normal recurring adjustments,

necessary to present fairly the Company's consolidated financial position as of September 30, 2010, their consolidated results of operations for the three and nine months ended September 30, 2010 and 2009, and their cash flows for the nine months ended September 30, 2010 and 2009. All significant inter-company balances have been eliminated in consolidation. The condensed consolidated financial statements as of September 30, 2010 and for the three and nine months ended September 30, 2010 and 2009 and related footnote disclosures are unaudited. The results of operations for the three and nine months ended September 30, 2010 are not necessarily indicative of the results to be expected for the entire year.

The December 31, 2009 condensed consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by GAAP.

Effective July 1, 2009, the Financial Accounting Standards Board ("FASB") established the Accounting Standards Codification ("ASC") as the primary source of authoritative GAAP recognized by the FASB to be applied to nongovernmental entities. Although the establishment of the ASC did not change current GAAP, it did change the way we refer to GAAP throughout this document to reflect the updated referencing convention.

MISSION WEST PROPERTIES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED
(dollars in thousands, except par value and per share amounts)
(unaudited)

The Company evaluates all joint venture arrangements for consolidation. The percentage interest in the joint venture, evaluation of control and whether a variable interest entity (“VIE”) exists are all considered in determining if the arrangement qualifies for consolidation in accordance with the Consolidation Topic of the FASB ASC 810. As of September 30, 2010, the Company consolidated one VIE in the accompanying condensed consolidated balance sheet in connection with an assignment of a lease agreement with an unrelated party, M&M Real Estate Control & Restructuring, LLC. See Note 3 to the Condensed Consolidated Financial Statements below for further discussion of this transaction.

Stock-Based Option Compensation Accounting

The Compensation-Stock Compensation Topic of the FASB ASC 718 addresses the accounting for stock options. It requires that the cost of all employee, director and consultant stock options, as well as other equity-based compensation arrangements, be reflected in the financial statements based on the estimated fair value of the awards. It is applicable to any award that is settled or measured in stock, including stock options, restricted stock, stock appreciation rights, stock units, and employee stock purchase plans. At September 30, 2010, the Company had one stock-based compensation plan.

The following table shows the activity and detail for the 2004 Equity Incentive Plan during the nine months ended September 30, 2010.

	Options Outstanding	Weighted Average Option Price Per Share
Balance, December 31, 2009	3,257,500	\$8.87
Options granted	171,000	\$6.99
Options exercised	(10,859)	\$6.14
Balance, September 30, 2010	3,417,641	\$8.79

The Company measures compensation cost for its stock options at fair value on the date of grant and recognizes compensation expense relating to the remaining unvested portion of outstanding stock options at the time of adoption ratably over the vesting period, generally four years. The fair value of the Company’s stock options is determined using the Black-Scholes option pricing model. Compensation expense related to the Company’s share-based awards is included in general and administrative expenses in the Company’s accompanying condensed consolidated statements of operations. Under the Compensation-Stock Compensation Topic of the FASB ASC 718, the Company recorded approximately \$52 and \$109 of expense for the three months ended September 30, 2010 and 2009, respectively, and approximately \$109 and \$243 of expense for share-based compensation relating to grants of stock options for the nine months ended September 30, 2010 and 2009, respectively.

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As of September 30, 2010, the total amount of unrecognized compensation cost related to unvested share-based compensation arrangements granted under the compensation plan was approximately \$92. This cost is expected to be recognized over a weighted-average period of 1.19 years.

Noncontrolling Interests

The Company adopted the noncontrolling interest provisions of the Consolidation Topic of the FASB ASC 810 effective January 1, 2009. It clarifies that a noncontrolling interest in a subsidiary is an ownership interest in a consolidated entity, which should be reported as equity in the parent's consolidated financial statements. It requires disclosure, on the face of the consolidated statement of operations, of those amounts of consolidated net income and other comprehensive other income attributable to controlling and noncontrolling interests, eliminating the past practice of reporting amounts of income attributable to noncontrolling interests as an adjustment in arriving at consolidated net income.

The following table presents a reconciliation of the December 31, 2009 and September 30, 2010 carrying amounts for equity and the related amounts of equity attributable to stockholders' equity and noncontrolling interests:

	Common Stock	Additional Paid-in Capital	Equity Distributions in Excess of Accumulated Earnings	Noncontrolling Interests	Total
	(dollars in thousands)				
Balance, December 31, 2009	\$ 22	\$ 170,606	\$ (25,784)	\$ 452,285	\$ 597,129
Net income	-	-	6,288	19,367	25,655
Amortization of previously granted share awards	-	109	-	-	109
Exercise of stock options	-	66	-	-	66
Conversions of operating partnership units	-	911	-	(911)	-
Cash dividends and distributions	-	-	(9,888)	(37,935)	(47,823)
Balance, September 30, 2010	\$ 22	\$ 171,692	\$ (29,384)	\$ 432,806	\$ 575,136

MISSION WEST PROPERTIES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED
(dollars in thousands, except par value and per share amounts)
(unaudited)

Noncontrolling interests represent the aggregate partnership interest in the operating partnership held by the operating partnership limited partner unit holders. Income allocated to noncontrolling interests is based on the unit holders' ownership percentage of the operating partnership. Because an O.P. unit is generally redeemable for cash or a share of common stock at the option of the Company, it is deemed to be equivalent to a share of common stock. Therefore, such transactions are treated as capital transactions and result in an allocation between stockholders' equity and noncontrolling interests in the accompanying condensed consolidated balance sheets to account for the change in the ownership of the underlying equity in the operating partnerships. The Company's noncontrolling interests represent the separate private ownership of the operating partnerships by the Berg Group (defined as Carl E. Berg, his brother Clyde J. Berg, members of their respective immediate families, and certain entities they control) and other non-affiliate interests. As of September 30, 2010, these interests accounted for approximately 79.2% of the ownership interests in the real estate operations of the Company on a consolidated weighted average basis. The amount of noncontrolling interests in net income is calculated by taking the net income of the operating partnerships (on a stand-alone basis) multiplied by the respective weighted average noncontrolling interests' ownership percentage.

Allocation of corporate general and administrative expenses to the operating partnerships is performed based upon shares and O. P. units outstanding for each operating partnership in relation to the total for all four operating partnerships.

Reclassifications

Certain reclassifications have been made to the previously reported 2009 condensed consolidated financial statements in order to conform to the 2010 presentation.

The following notes highlight significant changes to the notes to the Company's December 31, 2009 audited consolidated financial statements and should be read together with the consolidated financial statements and notes thereto included in the Company's 2009 Annual Report on Form 10-K filed on March 16, 2010.

Accounting Standards

The Consolidation Topic of the FASB ASC 810 provides a new accounting provision regarding the consolidation of variable interest entities ("VIEs"). The new accounting provision modifies the existing quantitative guidance used in determining the primary beneficiary of a VIE by requiring entities to qualitatively assess whether an enterprise is a primary beneficiary, based on whether the entity has (i) power over the significant activities of the VIE, and (ii) an obligation to absorb losses or the right to receive benefits that could be potentially significant to the VIE. Additionally, the accounting provision requires an ongoing reconsideration of the primary beneficiary and provides a framework for the events that triggers a reassessment of whether an entity is a VIE. The new accounting provision became effective for all new and existing VIEs on January 1, 2010. Upon adoption, the Company re-evaluated its interest in M&M Real Estate Control & Restructuring, LLC. Based on the evaluation performed, management has concluded that there is no change from its initial assessment and continues to consolidate the entity.

Effective February 2010, the Company adopted new accounting provisions which remove the requirement for the Company to disclose the date through which subsequent events have been evaluated in issued financial statements. The Company has evaluated subsequent events through the date the consolidated financial statements were issued.

3. Variable Interest Entity

Under the VIE provisions of the Consolidation Topic of the FASB ASC 810, a VIE must be consolidated by a company if it is subject to a majority of the entity's expected losses or is entitled to receive a majority of the entity's expected residual returns or both. In addition, the Consolidation Topic of the FASB ASC 810 requires disclosures about variable interest entities that a company is not required to consolidate, but in which it has a significant variable interest.

Under the Consolidation Topic of the FASB ASC 810, for an entity to qualify as a VIE one or more of the following three characteristics must exist:

1. The equity investment at risk is not sufficient to permit the entity to finance its activities without additional subordinated financial support by any parties, including the equity holders.
2. The equity investors lack one or more of the following essential characteristics of a controlling financial interest:
 - a. The direct or indirect ability to make decisions about the entity's activities through voting or similar rights.
 - b. The obligation to absorb the expected loss of the entity.
 - c. The right to receive the expected residual returns of the entity.
3. The equity investors have voting rights that are not proportionate to their economic interests, and the activities of the entity involve or are conducted on behalf of an investor with a disproportionately small voting interest.

MISSION WEST PROPERTIES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED
(dollars in thousands, except par value and per share amounts)
(unaudited)

In August 2007, one of the Company's tenants, Ciena, entered into an assignment of lease agreement with an unrelated party, M&M Real Estate Control & Restructuring, LLC ("M&M Real Estate"), in connection with leases for approximately 445,000 rentable square feet located in San Jose, California. As a result of the Assignment, M&M Real Estate assumed all of Ciena's remaining obligations under these leases and received a payment from Ciena of \$53,000, of which \$7,000 was reserved for tenant improvements. At the same time, the Company entered into a consent for assignment of lease with both parties and a mutual release agreement with Ciena, pursuant to which all of Ciena's obligations under these leases were effectively transferred to M&M Real Estate. M&M Real Estate is obligated to continue to perform all of the obligations under the assumed Ciena leases and has the right to sublease any or all of the 445,000 rentable square feet vacated by Ciena for the remainder of the current lease term, which expire in 2011. Under the terms of the assignment of lease agreement, the Company received monthly rent payments of approximately \$789 from July 2007 through June 2008, received \$818 from July 2008 through June 2009, received \$849 from July 2009 through June 2010, is receiving \$881 from July 2010 through June 2011 and will receive \$915 from July 2011 through December 2011. Based upon the provisions of the Consolidation Topic of the FASB ASC 810, the Company determined that M&M Real Estate is a VIE. The Company further determined that it is the primary beneficiary of this VIE, and therefore has consolidated this entity for financial reporting purposes. Upon consolidation, the Company recognized a lease termination fee of \$46,000 in August 2007.

Factors considered by the Company in determining whether M&M Real Estate should be considered a VIE for financial reporting purposes included the following:

- No equity was contributed by the partners in the formation of M&M Real Estate.
- At present, the assigned leases are the only properties under management by M&M Real Estate.
- M&M Real Estate does not have an operating history that demonstrates its ability to finance its activities without additional subordinated financial support.
- All revenues, other than interest income, are generated by M&M Real Estate from the Company in the form of fees or commissions.

The Company remains at risk with respect to the assigned leases because if M&M Real Estate's operating expenses exceed its interest income, fees and commissions there would be insufficient funds to meet the assigned lease obligation without additional financial support from equity holders or other parties. The Company, which had released the original tenants from its obligations under the leases, would have to absorb the majority of any loss, making it the primary beneficiary of M&M Real Estate's activities.

4. Restricted Cash

Restricted cash totaled approximately \$89 on September 30, 2010. The entire amount represents cash held by M&M Real Estate, a consolidated VIE. The Company does not have possession or control over these funds or any right to receive them except in accordance with the payment terms of the lease agreement that has been assigned to the VIE and any other additional agreements with the VIE.

5. Restricted Investment in Marketable Securities

The Company adjusts marketable securities to fair value at the end of each accounting period, with the corresponding gain and loss recorded in realized and unrealized gain and loss from investment in the Company's condensed

consolidated statement of operations. Restricted investment in marketable securities totaled \$0 as of September 30, 2010. In the second quarter of 2010, all of the marketable securities were sold for a net total of approximately \$15,913. The Company realized a net cash gain of approximately \$9,601, which includes approximately \$298 in cash dividends received during the holding period. For the nine months ended September 30, 2010, the Company recorded net realized and unrealized gain of approximately \$4,067 related to the sale of the marketable securities and the increase in fair value of the marketable securities. For the nine months ended September 30, 2009, the Company recorded unrealized gain of approximately \$4,140 related to the increase in fair value of the marketable securities. The Company used the proceeds from the sale to pay down its short-term borrowings from the Berg Group.

In accordance with the provisions of the Investments–Debt and Equity Securities Topic of the FASB ASC 320, investments in debt and equity “marketable” securities are classified at acquisition, and on subsequent reporting dates, into one of the following categories: (a) Trading Securities - debt and equity securities purchased and held principally for the purpose of selling them in the near future. (b) Available-for-Sale Securities - debt securities not classified as held-to-maturity, and debt and equity securities not classified as trading securities. (c) Held-to-Maturity Debt Securities - those debt securities for which the company has the “positive intent and ability to hold the securities to maturity.”

MISSION WEST PROPERTIES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED
(dollars in thousands, except par value and per share amounts)
(unaudited)

The Company's restricted investment in marketable securities was classified as a trading security, and accordingly unrealized gains and losses (differences between the initial cost and the fair value at the balance sheet date) were included in net income, and interest and dividend revenue, as well as realized gains and losses on sales, were included in net income. The marketable securities were classified as Level 1 of the fair value hierarchy in accordance with the provisions of the Fair Value Measurements and Disclosures Topic of the FASB ASC 820 and thus measured at fair value using quoted market prices for identical instruments in active markets from an independent third party source.

6. Stock Transactions

During the nine months ended September 30, 2010, stock options to purchase 10,859 shares of the Company's common stock were exercised at \$6.14 per share. Total proceeds to the Company were approximately \$67. During the same period, three limited partners exchanged a total of 132,000 O.P. units for 132,000 shares of the Company's common stock under the terms of the Exchange Rights Agreement among the Company and all limited partners of the operating partnerships resulting in a reclassification of approximately \$911 from noncontrolling interests to stockholders' equity. Neither the Company nor the operating partnerships received any proceeds from the issuance of the common stock in exchange for O.P. units. Under the limited partnership agreements, each exchange is treated as the purchase of additional O.P. units of the general partner interest by the Company in exchange for stock, and the contribution of additional capital to the partnership by the Company equal in amount to the value of the stock issued in exchange for the limited partnership interests.

7. Net Income Per Share

Basic operating net income per share is computed by dividing net income by the weighted average number of common shares outstanding for the period. Diluted operating net income per share is computed by dividing net income by the sum of the weighted-average number of common shares outstanding for the period plus the assumed exercise of all dilutive securities using the treasury stock method.

The computation for weighted average shares is detailed below:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2010	2009	2010	2009
Weighted average shares outstanding (basic)	21,976,679	21,770,211	21,938,857	21,717,713
Incremental shares from assumed option exercise	132,712	132,176	156,745	140,354
Weighted average shares outstanding (diluted)	22,109,391	21,902,387	22,095,602	21,858,067

At September 30, 2010, outstanding options to purchase 2,223,500 and 2,052,500 shares of common stock were excluded from the computation of diluted net income per share under the treasury stock method for the three and nine months ended September 30, 2010, respectively, because the option exercise price was greater than the weighted average closing price of the Company's common stock during the period. The outstanding O.P. units, which are exchangeable at the unit holder's option, subject to certain conditions, for shares of common stock on a one-for-one basis have been excluded from the diluted net income per share calculation, as there would be no effect on the

calculation after adding the noncontrolling interests' share of income back to net income. The total number of O.P. units outstanding at September 30, 2010 and 2009 was 83,272,965 and 83,504,965, respectively.

8. Related Party Transactions

As of September 30, 2010, the Berg Group owned 75,826,384 O.P. units. The Berg Group's combined ownership of O.P. units and shares of common stock as of September 30, 2010 represented approximately 74% of the total equity interests, assuming conversion of all O.P. units outstanding into the Company's common stock.

As of September 30, 2010, debt in the amount of approximately \$7,860 was due the Berg Group under a mortgage note established May 15, 2000 in connection with the acquisition of a 50% interest in Hellyer Avenue Limited Partnership, the obligor under the mortgage note. The mortgage note bears interest at 7.65% and principal payments are amortized over 20 years. Interest expense incurred in connection with the mortgage note was approximately \$152 and \$162 for the three months ended September 30, 2010 and 2009, respectively, and \$464 and \$493 for the nine months ended September 30, 2010 and 2009, respectively.

As of September 30, 2010, debt in the amount of \$0 was due the Berg Group under a short-term note. During the first nine months of 2010, the Company borrowed a total of approximately \$52,963 from the Berg Group under a short-term note payable in connection with the quarterly dividend distributions and repaid \$62,288 to the Berg Group, which included the balance owed at December 31, 2009. The note payable interest was calculated at LIBOR plus 1.75%. Interest expense incurred in connection with the loan was approximately \$62 and \$40 for the three months ended September 30, 2010 and 2009, respectively, and \$375 and \$61 for the nine months ended September 30, 2010 and 2009, respectively.

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(dollars in thousands, except par value and per share amounts)
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On September 17, 2009, the Superior Court of the County of Santa Clara of the State of California issued a final decision and entry of judgment in favor of Republic Properties Corporation in the case of Mission West Properties, L.P. v. Republic Properties Corporation. The court's decision held that Republic Properties Corporation is entitled to retain its partnership interest in the Hellyer Avenue Limited Partnership and all prior unpaid distributions must be paid to Republic Properties Corporation by Mission West Properties L.P., one of the Company's controlled operating partnerships. Because Republic Properties Corporation's interest in the Hellyer Avenue Limited Partnership had been transferred to Berg & Berg Enterprises, Inc. after the interest had been forfeited under the terms of the partnership agreement and past distributions from profits on account of that interest had been paid to Berg & Berg Enterprises, Inc., the Company accrued approximately \$1,021 in interest receivable in 2009 due from Berg & Berg Enterprises, Inc. with respect to those payments. The interest income accrual was calculated at an interest rate of LIBOR plus 1.25%. See Note 9 to Condensed Consolidated Financial Statements below for details.

During the first nine months of 2010 and 2009, Carl E. Berg or entities controlled by him held financial interests in several companies that lease space from the operating partnerships, which include companies where Mr. Berg has a greater than 10% ownership interest. These related tenants contributed approximately \$277 and \$273 in rental income for the three months ended September 30, 2010 and 2009, respectively, and \$824 and \$845 in rental revenue for the nine months ended September 30, 2010 and 2009, respectively.

Under the Company's charter, bylaws and agreements with the Berg Group, the individual members of the Berg Group are prohibited from acquiring or holding shares of the Company's common stock if such acquisition would result in their beneficial ownership percentage of the Company's common stock causing the Company to violate any REIT qualification requirement. Currently their share ownership is below a level at which rent from related tenants would be excluded in determining compliance with REIT qualification tests.

The Berg Group has a commitment to pay approximately \$7,500 toward the construction of an approximately 75,000 to 90,000 square foot building in connection with the Company's 2001 acquisition of 245 Caspian in Sunnyvale which is comprised of approximately three acres of unimproved land. The Company has recorded this portion of the purchase price paid to the Berg Group in "Other assets" on its condensed consolidated balance sheets. The Berg Group plans to satisfy this commitment to construct a building when requested by the Company following the approval of the Independent Directors Committee. Currently there is no tenant or prospective tenant demand for a building at this site that would justify the construction of a new building to which this commitment could be applied.

The Company currently leases office space owned by Berg & Berg Enterprises for the Company's headquarters. Rental amounts and overhead reimbursements paid to Berg & Berg Enterprises were \$30 for the three months ended September 30, 2010 and 2009, and \$90 for the nine months ended September 30, 2010 and 2009.

9. Commitments and Contingencies

From time to time, the Company is engaged in legal proceedings arising in the ordinary course of business. The Company does not expect any of such proceedings to have a material adverse effect on its cash flows, financial condition or results of operations. The Company is currently involved in the following legal proceeding, which it believes will not have a material adverse effect on its operating results, cash flows or financial condition.

Mission West Properties, L.P. v. Republic Properties Corporation, et al. Santa Clara County Superior Court, Case No. CV 796249. Republic Properties Corporation (“RPC”) is a former 50% partner with Mission West Properties, L.P. in the Hellyer Avenue Limited Partnership (“Hellyer LP”), which was formed in July 2000. Under the terms of the Hellyer LP partnership agreement and other related contracts, Mission West Properties, L.P. (“MWP”) had the right to obtain RPC’s entire interest in Hellyer LP in the event of certain payment defaults which occurred in August 2000. Therefore, on September 1, 2000, MWP, as the general partner of Hellyer LP, ceased all allocations of income and cash flow to RPC and exercised its right under the partnership agreement to cancel RPC’s entire interest in the partnership. Following discussions with and approval by the Independent Directors Committee, the Company authorized the transfer of RPC’s interest in Hellyer LP to Berg & Berg Enterprises, Inc. (“BBE”). Under the Berg Land Holdings Option Agreement and the Acquisition Agreement dated as of May 14, 1998, the Company acting through the Independent Directors Committee had the right, but not the obligation, to reacquire the property interest and the related distributions related to the property interest at any time. The transfer was effective as of September 1, 2000. On November 20, 2000, RPC commenced a lawsuit against MWP in the Circuit Court of Maryland for Baltimore City. After lengthy litigation, which included a trial on the merits and subsequent appeals, in April 2006, Maryland’s highest court upheld an earlier Maryland Appeals Court ruling in favor of MWP, finding that the Circuit Court of Maryland could not assert personal jurisdiction over MWP in Maryland. The court vacated the judgment and decision in the trial court and dismissed the entire Maryland suit. In February 2001, while the Maryland case was pending, the Company filed a suit against RPC in the Superior Court of the State of California for the County of

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Santa Clara. The case was stayed pending resolution of the Maryland case, and the Company dismissed its suit on March 4, 2005. In April 2005, RPC submitted a motion asking the Superior Court to reinstate the case, which the Court granted on May 25, 2005. A trial in the superior court commenced in February 2009. On September 17, 2009, the superior court issued a final decision and entry of judgment in favor of RPC upholding its interest in Hellyer L.P. and awarding damages of approximately \$6,625, together with pre-judgment interest at a 10% annual rate through September 3, 2009 of \$2,692, for a total of approximately \$9,317. As a result, the Company recorded an additional \$469 in interest expense. The Company has filed an appeal. On October 5, 2009, the Company deposited approximately \$13,975 with the clerk of the Santa Clara County Superior Court, of which approximately \$4,658, or 50% of \$9,317, was a deposit to appeal the court's final decision. The additional \$4,658 appeal deposit is refundable regardless of the outcome of the appeal process. Pending the outcome of the appeal, the Company has accrued approximately \$3,702 in interest payable on the amount of past distributions that would be payable to RPC by Hellyer LP based on the amount of the judgment at the legal rate of interest of 10%. In addition, the Company has accrued approximately \$1,021 in interest receivable due from BBE because past distributions with respect to RPC's interest in Hellyer LP were paid to BBE, which interest income accrual was calculated at an interest rate of LIBOR plus 1.25%.

Since the inception of Hellyer LP, the Company has accounted for the properties owned by the partnership on a consolidated basis, with reductions for the noncontrolling interests held by the noncontrolling partner (first RPC and then BBE). In each period, the Company has accrued amounts payable by Hellyer LP to the noncontrolling interest partner, including BBE prior to payment. BBE's share of earnings allocated to its 50% noncontrolling interest was approximately \$737 and \$1,040 in the first nine months of 2010 and 2009, respectively. As of September 30, 2010, accumulated cash flow distributions from Hellyer LP totaling approximately \$7,112 were accrued and distributed to BBE. If the Company's litigation with RPC is ultimately decided in RPC's favor, the Company anticipates that BBE will be required to return all distributions paid to BBE and RPC's former interest in Hellyer LP to RPC. In anticipation of this contingency, since October 2003, the Company has recorded such distributions as an account receivable from BBE, which is included in "Other assets" on the Company's consolidated balance sheets, with an offsetting account payable to BBE.

The Independent Directors Committee of the Board of Directors has exercised the Company's right to acquire on behalf of the Company the former RPC interest and related distributions from Berg & Berg Enterprises, Inc. under the terms of the Berg Land Holdings Option Agreement between the Company and the Berg Group if the litigation is ultimately decided in favor of the Company.

Guarantees and Indemnities

Under its articles of incorporation and bylaws, the Company has agreed to indemnify its officers and directors for certain events or occurrences arising as a result of the officer or director's serving in such capacity. The maximum potential amount of future payments the Company could be required to make under these indemnification agreements is unlimited. The Company believes the estimated fair value of its obligations under these indemnification agreements is minimal and has recorded no liabilities for these agreements as of September 30, 2010.

The Company also enters into indemnification provisions under its agreements with other companies in the ordinary course of business, typically with lenders, joint venture partners, contractors, and tenants. Under these provisions the Company typically agrees to indemnify and hold harmless the indemnified party for losses suffered or incurred by the indemnified party as a result of certain kinds of activities or inactions of the Company. These indemnification provisions generally survive termination of the underlying agreement. The maximum potential amount of future payments the Company could be required to make under these indemnification provisions is unlimited. To date, the

Company has not incurred material costs to defend lawsuits or settle claims related to these indemnification agreements. As a result, the Company believes the estimated fair value of these agreements is minimal. Accordingly, the Company has recorded no liabilities for these agreements as of September 30, 2010.

Seismic Activity

The Company's properties are located in an active seismic area of Silicon Valley. Insurance policies currently maintained by the Company do not cover seismic activity, although they do cover losses from fires after an earthquake.

Environmental Issues

The environmental investigations that have been conducted on the Company's properties have not revealed any environmental liability that the Company believes would have a material adverse effect on its financial condition, results of operations and assets, and the Company is not aware of any such liability. Nonetheless, it is possible that there are material environmental liabilities of which the Company is unaware. In addition, the Company cannot assure that future laws, ordinances, or regulations will not impose any material environmental liability, or that the current environmental condition of the properties has not been, or will not be, affected by tenants and occupants of the properties, by the condition of properties in the vicinity of the properties, or by third parties unrelated to the Company.

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The real estate sales provisions of the Property, Plant, and Equipment Topic of the FASB ASC 360 addresses financial accounting and reporting for the impairment and disposal of long lived assets. In general, income or loss attributable to the operations and sale of property and the operations related to property held for sale is classified as discontinued operations in the condensed consolidated statements of operations. Prior period condensed consolidated statements of operations presented in this report have been reclassified to reflect the income or loss related to properties that were under contract to be sold and presented as discontinued operations in 2009. All periods presented in this report will likely require further reclassification in future periods if there are properties held for sale or property sales occur.

As of September 30, 2010, there was one property under contract to be sold or otherwise disposed of which would qualify as assets held for sale and presented as discontinued operations. See Note 11 below for details of the property sale. Condensed results of operations for this property for the three and nine months ended September 30, 2010 and 2009 are as follows:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2010	2009	2010	2009
	(dollars in thousands)			
	(unaudited)			
Operating revenues:				
Rental income	\$ 11	\$ 11	\$ 34	\$ 44
Tenant reimbursements	15	15	43	49
Total operating revenues	26	26	77	93
Operating expenses:				
Property operating, maintenance and real estate taxes	62	78	167	196
Depreciation and amortization	58	58	174	174
Total operating expenses	120	136	342	370
(Loss) from operations of property held for sale	\$ (94)	\$ (110)	\$ (265)	\$ (277)

11. Subsequent Events

On October 7, 2010, the Company paid dividends of \$0.15 per share of common stock to all common stockholders of record as of September 30, 2010. On the same date, the operating partnerships paid a distribution of \$0.15 per O.P. unit to all O.P. unit holders. Aggregate dividends and distributions amounted to approximately \$15,793.

On October 28, 2010, the Company disposed of one R&D property located at 1325-1375 McCandless Drive in Milpitas, California consisting of approximately 78,000 rentable square feet. A total net gain of approximately \$6,203 will be recognized and classified as discontinued operations on the total sales price of \$14,123.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

This Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the accompanying condensed consolidated financial statements and notes thereto under Part I, Item 1 of this Report and our audited consolidated financial statements and notes thereto contained in our Annual Report on Form 10-K as of and for the year ended December 31, 2009. The results for the three and nine months ended September 30, 2010 are not necessarily indicative of the results to be expected for the entire fiscal year ending December 31, 2010.

Forward-Looking Information

This quarterly report on Form 10-Q contains forward-looking statements within the meaning of the federal securities laws. We intend such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Reform Act of 1995, and are including this statement for purposes of complying with these safe harbor provisions. Forward-looking statements, which are based on certain assumptions and describe future plans, strategies and expectations of the Company, are generally identifiable by use of the words "believe," "expect," "intend," "anticipate," "estimate," "project" or similar expressions. Additionally, all disclosures under Part I, Item 3 constitute forward-looking statements. Our ability to predict results or the actual effect of future plans or strategies is inherently uncertain.

Factors that could have a material adverse effect on our operations and future prospects or would cause actual results in the future to differ materially from any of our forward-looking statements include, but are not limited to, the following:

- the current turmoil in the credit markets could limit the demands for R&D space and affect the overall availability and cost of credit,
 - economic conditions generally and the real estate market specifically,
 - the occupancy rates of the properties,
 - rental rates on new and renewed leases,
 - legislative or regulatory provisions (including changes to laws governing the taxation of REITs),
 - availability of capital,
 - interest rates,
 - competition,
- supply of and demand for R&D, office and industrial properties in our current and proposed market areas,
 - tenant defaults and bankruptcies,
 - lease term expirations and renewals,
- changes in general accounting principles, policies and guidelines applicable to REITs, and
- ability to timely refinance maturing debt obligations and the terms of any such refinancing.

These risks and uncertainties, together with the other risks described under Part I, Item 1A - "Risk Factors" of our 2009 Annual Report on Form 10-K and from time to time in our other reports and documents filed with the Securities and Exchange Commission ("SEC"), should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements.

Overview

We acquire, market, lease, and manage R&D/office properties, primarily located in the Silicon Valley portion of the San Francisco Bay Area. As of September 30, 2010, we owned and managed 112 properties totaling approximately 8.1 million rentable square feet through four limited partnerships, or operating partnerships, for which we are the sole

general partner. This class of property is designed for research and development and office uses and, in some cases, includes space for light manufacturing operations with loading docks. We believe that we have one of the largest portfolios of R&D/office properties in the Silicon Valley. As of September 30, 2010, two tenants individually leased in excess of 300,000 rentable square feet from us: Microsoft Corporation and Apple, Inc.

For federal income tax purposes, we have operated as a self-managed, self-administered and fully integrated real estate investment trust ("REIT") since the beginning of fiscal 1999.

Our acquisition, growth and operating strategy incorporates the following elements:

- capitalizing on opportunistic acquisitions from third parties of high-quality R&D/office properties that provide attractive initial yields and significant potential for growth in cash-flow;
 - focusing on general purpose, single-tenant Silicon Valley R&D/office properties for information technology companies in order to maintain low operating costs, reduce tenant turnover and capitalize on our relationships with these companies and our extensive knowledge of their real estate needs; and
- maintaining prudent financial management principles that emphasize current cash flow while building long-term value, the acquisition of pre-leased properties to reduce development and leasing risks and the maintenance of sufficient liquidity to acquire and finance properties on desirable terms.

Current Economic Environment

All of our properties are located in the Northern California area known as Silicon Valley, which generally consists of portions of Santa Clara County, Southwestern Alameda County, Southeastern San Mateo County and Eastern Santa Cruz County. Historically, the Silicon Valley R&D property market has fluctuated with the local economy. The Silicon Valley economy and business activity slowed markedly from 2001 through 2006 and grew slowly until the second half of 2008. Since September 2008, the impact of the worldwide recession has adversely affected the local economy. According to a recent report by Cassidy Turley BT Commercial Real Estate (the "CTBT Report"), which we consider to be a useful publicly available source of relevant market data, the vacancy rate for Silicon Valley R&D property was approximately 19.3% in late 2009 and 19.1% at the end of the third quarter of 2010. Total vacant R&D square footage in Silicon Valley at the end of the third quarter of 2010 amounted to approximately 29.9 million square feet, of which 12.7%, or 3.8 million square feet, were being offered under subleases. According to the CTBT Report, total negative net absorption (which is the computation of gross square footage leased less gross new square footage vacated for the period presented) in 2009 amounted to approximately 5.2 million square feet, and in the first nine months of 2010 there was total negative net absorption of approximately 0.28 million square feet. Also according to the CTBT Report, the average asking market rent per square foot at the end of the third quarter of 2010 was \$1.00 per month compared with \$1.03 per month in late 2009. The Silicon Valley R&D property market is characterized by a substantial number of submarkets, with rent and vacancy rates varying by submarket and location within each submarket. Individual properties within any particular submarket presently may be leased above or below the current average asking market rental rates within that submarket and the region as a whole. Due to the substantial overhang of vacant R&D properties throughout Silicon Valley, we believe that we are unlikely to see a sustainable recovery in the leasing market for our properties prior to 2012.

Our occupancy rate at September 30, 2010 was 67.8% compared with 65.7% at September 30, 2009. We believe that our occupancy rate could decline further if key tenants seek the protection of bankruptcy laws, consolidate operations or discontinue operations. In addition, excluding 53,000 rentable square feet of month-to-month lease, leases with respect to approximately 48,000 rentable square feet are scheduled to expire during the remainder of 2010 and approximately 739,000 rentable square feet are scheduled to expire in 2011. The properties subject to these leases may take anywhere from 24 to 40 months or longer to re-lease. We believe that the average 2010 renewal rental rates for our properties will be approximately equal to, or perhaps below, current market rents, but we cannot give any assurance that leases will be renewed or that available space will be re-leased at rental rates equal to or above the current quoted market rates.

Despite our strategic focus on single tenant properties and leases, in order to meet market conditions, we have been, and expect to continue leasing less than the entire premises of some of our R&D properties to a single tenant from time to time. Leasing our R&D properties, which generally have been built for single tenant occupancy, to multiple tenants can increase our leasing costs and operating expenses and reduce the profitability of our leasing activities.

If we are unable to lease a significant portion of any vacant space or space subject to expiring leases; if we experience significant tenant defaults as a result of the current economic downturn; if we are not able to lease space at or above current market rates; if we restructure existing leases and lower existing rents in order to retain tenants for an extended term; or if we increase our lease costs and operating expenses substantially to accommodate multiple tenants in our R&D properties, our results of operations and cash flows will be affected adversely. Furthermore, in this event it is probable that our board of directors will reduce the quarterly dividend on the common stock and the outstanding O.P. units. Our operating results and ability to pay dividends at current levels remain subject to a number of material risks, as indicated under the caption "Forward-Looking Information" above and in the section entitled "Risk Factors" in our most recent Annual Report on Form 10-K.

Critical Accounting Policies and Estimates

We prepare the condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America (“GAAP”), which requires us to make certain estimates, judgments and assumptions that affect the reported amounts in the accompanying condensed consolidated financial statements, disclosure of contingent assets and liabilities and related footnotes. Accounting and disclosure decisions with respect to material transactions that are subject to significant management judgments or estimates include impairment of long lived assets, deferred rent reserves, and allocation of purchase price relating to property acquisitions and the related depreciable lives assigned. Actual results may differ from these estimates under different assumptions or conditions.

Critical accounting policies are defined as those that require management to make estimates, judgments and assumptions, giving due consideration to materiality, in certain circumstances that affect amounts reported in the condensed consolidated financial statements, and potentially result in materially different results under different conditions and assumptions. We believe that the following best describe our critical accounting policies:

Business Combinations. The provisions of the Business Combinations Topic of the FASB ASC 805 state that the fair value of the real estate acquired is allocated to acquired tangible assets, consisting of land, building and tenant improvements, and identified intangible assets and liabilities, consisting of the value of above-market and below-market leases, acquired in-place leases and the value of tenant relationships, based in each case on their fair values. The determination of the tangible and intangible assets' useful lives are guided by the provision. The provision requires that acquisition-related costs and restructuring costs be recognized separately from the business combination and expensed as incurred.

The capitalized above-market lease values and the capitalized below-market lease values are amortized as an adjustment to rental income over the initial lease term while amortization of in-place lease value intangible asset is included in depreciation and amortization in the expense section of our condensed consolidated statements of operations. If we do not appropriately allocate these components or we incorrectly estimate the useful lives of these components, our computation of depreciation and amortization expense may not appropriately reflect the actual impact of these costs over future periods, which will affect net income.

Impairment of Long-Lived Assets. We review real estate assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable in accordance with the impairment provisions of the Property, Plant, and Equipment Topic of the FASB ASC 360. We evaluate the recoverability of our investments in real estate assets to be held and used each quarter and record an impairment charge when there is an indicator of impairment and the undiscounted projected cash flows are less than the carrying amount for a particular property. If impairment is recognized, the reduced carrying amount of the asset will be accounted for at its new cost. For a depreciable asset, the new cost will be depreciated over the asset's remaining useful life. Generally, fair values are estimated using discounted cash flow, replacement cost or market comparison analyses. The process of evaluating for impairment requires estimates as to future events and our views of market and economic conditions, which are subject to varying market factors, such as the vacancy rates, future rental rates, lease periods, deferred maintenance and operating costs for R&D facilities in the Silicon Valley area and related submarkets. Therefore, it is reasonably possible that a change in estimate resulting from judgments as to future events could occur which would affect the recorded amounts of the property.

Allowance for Doubtful Accounts and Deferred Rent. We must estimate the uncollectibility of our accounts receivable based on the evaluation of our tenants' financial position, analyses of accounts receivable and current economic trends. We also make estimates for reserves against our deferred rent receivable for existing tenants with the potential of early termination, bankruptcy or ceasing operations. We charge or credit rental income for increases or decreases to our deferred rent reserves. Our estimates are based on our review of tenants' payment histories, the remaining lease term, whether or not the tenant is currently occupying our building, publicly available financial information and such additional information about their financial condition as tenants provide to us. The information available to us might lead us to overstate or understate these reserve amounts. The use of different estimates or assumptions could produce different results. Moreover, actual future collections of accounts receivable or reductions in future reported rental income due to tenant bankruptcies or other business failures could differ materially from our estimates.

Consolidated Joint Ventures. We, through an operating partnership, own three properties that are in joint ventures of which we have controlling interests. We manage and operate all three properties. We recognize these properties and 100% of their operating results in our condensed consolidated financial statements, with appropriate allocation to noncontrolling interests, because we have operational and financial control of the investments. We make judgments and assumptions about the estimated monthly payments made to our noncontrolling interest joint venture partners, which are reported with our periodic results of operations. Actual results may differ from these estimates under different assumptions or conditions.

Investment in Unconsolidated Joint Venture. We evaluate all joint venture arrangements for consolidation. The percentage interest in the joint venture, evaluation of control and whether a variable interest entity (“VIE”) exists are all considered in determining if the arrangement qualifies for consolidation in accordance with the VIE provisions of the Consolidation Topic of the FASB ASC 810. We, through an operating partnership, have a 50% non-controlling limited partnership interest in one unconsolidated joint venture. This investment is not consolidated because we do not exercise significant control over major operating and financial decisions. We account for this joint venture interest using the equity method of accounting.

Fair Value of Financial Instruments. We adopted the provisions of the Fair Value Measurements and Disclosures Topic of the FASB ASC 820 for our financial assets and liabilities measured at fair value on a recurring basis. The provisions define fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. It also specifies a three-level hierarchy of valuation techniques based upon whether the inputs reflect assumptions other market participants would use based upon market data obtained from independent sources (observable inputs) or reflect its own assumptions of market participant valuation (unobservable inputs) and requires the use of observable inputs if such data is available without undue cost and effort.

The only financial asset or liability recorded at fair value in our consolidated financial statements is the restricted investment in marketable securities. We determined the fair value for the marketable securities using quoted prices in active markets for identical securities.

Our financial instruments include cash and cash equivalents, accounts receivable, accounts payable, and debt. Considerable judgment is required in interpreting market data to develop estimates of fair value. Our estimates of fair value are not necessarily indicative of the amounts that we could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts. Cash and cash equivalents, accounts receivable, and accounts payable are carried at amounts that approximate their fair values due to their short-term maturities. The carrying amounts of our variable rate debt approximate fair value since the interest rates on these instruments are equivalent to rates currently offered to us. For fixed rate debt, we estimate fair value by using discounted cash flow analyses based on borrowing rates for similar kinds of borrowing arrangements.

Stock-Based Compensation. The Compensation-Stock Compensation Topic of the FASB ASC 718 requires that the cost of all employee, director and consultant stock options, as well as other equity-based compensation arrangements, be reflected in the financial statements based on the estimated fair value of the awards. It is applicable to any award that is settled or measured in stock, including stock options, restricted stock, stock appreciation rights, stock units, and employee stock purchase plans. Compensation cost under the Compensation-Stock Compensation Topic of the FASB ASC 718 may differ due to different assumptions and treatment of forfeitures.

Revenue Recognition. Rental income is recognized on the straight-line method of accounting required by GAAP under which contractual rent payment increases are recognized evenly over the lease term, regardless of when the rent payments are received by us. The difference between recognized rental income and rental cash receipts is recorded as “deferred rent receivable” on the condensed consolidated balance sheets.

Rental income is affected if existing tenants terminate or amend their leases. We try to identify tenants who may be likely to declare bankruptcy, cease operations or are likely to seek a negotiated settlement of their obligation. By anticipating these events in advance, we expect to take steps to minimize their impact on our reported results of operations through lease renegotiations, reserves against deferred rent, and other appropriate measures. Our judgments and estimations about tenants’ capacity to continue to meet their lease obligations will affect the rental income recognized. Material differences may result in the amount and timing of our rental income for any period if we made different judgments or estimations.

The real estate sales provisions of the Property, Plant, and Equipment Topic of the FASB ASC 360 establish accounting standards for recognizing profit or loss on sales of real estate. The gain on the sale is only recognized proportionately as the seller receives payments from the purchaser. Interest income is recognized on an accrual basis, when appropriate.

Lease termination fees are recognized as other income when there is a signed termination letter agreement, all of the conditions of the agreement have been met, and when the tenant no longer has the right to occupy the property. These fees are paid by tenants who want to terminate their lease obligations before the end of the contractual term of the lease. We cannot predict or forecast the timing or amounts of future lease termination fees.

We recognize income from rent, tenant reimbursements and lease termination fees and other income once all of the following criteria are met:

- the agreement has been fully executed and delivered;
 - services have been rendered;
- the amount is fixed and determinable; and
 - collectibility is reasonably assured.

With regard to critical accounting policies, where applicable, we have explained and discussed the criteria for identification and selection, methodology in application and impact on the financial statements with the Audit

Committee of our Board of Directors. The Audit Committee has reviewed the critical accounting policies we identified.

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Results of Operations

Comparison of the three and nine months ended September 30, 2010 with the three and nine months ended September 30, 2009

As of September 30, 2010, through our controlling interests in the operating partnerships, we owned 112 properties totaling approximately 8.1 million rentable square feet compared with 111 properties totaling approximately 8.0 million rentable square feet owned by us as of September 30, 2009. The increase in total rentable square footage was due to the acquisition of an R&D/office property consisting of approximately 41,400 rentable square feet since the third quarter of 2009.

Comparison of rental income from real estate for the three and nine months ended September 30, 2010 and 2009 is as follows:

	Three Months Ended September 30,			% Change by Property Group	
	2010	2009	\$ Change		
	(dollars in thousands)				
Same Property (1)	\$ 20,541	\$ 20,431	\$ 110	0.5	%
2010 Acquisition	55	-	55	100.0	%
Total	\$ 20,596	\$ 20,431	\$ 165	0.8	%

	Nine Months Ended September 30,			% Change by Property Group	
	2010	2009	\$ Change		
	(dollars in thousands)				
Same Property (1)	\$ 61,892	\$ 61,478	\$ 414	0.7	%
2010 Acquisitions	166	-	166	100.0	%
Total	\$ 62,058	\$ 61,478	\$ 580	0.9	%

(1) "Same Property" is defined as properties owned by us prior to 2009 that we still owned as of September 30, 2010.

Rental Income from Real Estate Operations

For the quarter ended September 30, 2010, rental income from real estate increased by approximately \$0.2 million, or 0.8%, from \$20.4 million for the three months ended September 30, 2009 to \$20.6 million for the three months ended September 30, 2010. For the nine months ended September 30, 2010, rental income from real estate increased by approximately \$0.6 million, or 0.9%, from \$61.5 million for the nine months ended September 30, 2009 to \$62.1 million for the nine months ended September 30, 2010. In both periods, the increase in rental income resulted primarily from new leases since September 30, 2009. Our occupancy rate at September 30, 2010 was approximately 67.8%, compared with 65.7% at September 30, 2009.

Other Income

Other income of approximately \$0.28 million for the three months ended September 30, 2010 included approximately \$0.25 million from management fees and \$0.03 million from miscellaneous income. Other income of approximately \$0.28 million for the three months ended September 30, 2009 included approximately \$0.25 million from management fees and \$0.03 million from miscellaneous income. For the nine months ended September 30, 2010, other income of approximately \$2.14 million included approximately \$0.76 million from management fees, \$1.28 million from litigation proceeds and \$0.10 million from miscellaneous income. For the nine months ended September 30, 2009, other income of approximately \$0.91 million included approximately \$0.74 million from management fees, \$0.06 million from an insurance claim and \$0.11 million from miscellaneous income.

Expenses from Operations

Property operating, maintenance and property taxes for the third quarter of 2010 and 2009 were approximately \$6.7 million. Tenant reimbursements decreased by approximately (\$1.4) million, or (31.6%), from \$4.5 million for the three months ended September 30, 2009 to \$3.1 million for the three months ended September 30, 2010 due to a one-time \$1.0 million refund to a tenant relating to annual common area charges reconciliation. We anticipated supplemental tax assessments from the county tax assessor for completed improvements at the tenant's property. The tenant was paying a monthly estimated property tax amount in addition to rent. However, the county tax assessor has not issued a supplemental tax assessment to date, and we no longer felt that it was reasonable to continue to retain the tenant's overpayment for property taxes. The county tax assessor may eventually issue a supplemental tax assessment in the future, which the tenant will be liable. The level of tenant reimbursements is affected by vacancies because certain recurring expenses such as property insurance, property taxes, and other fixed operating expenses are not recoverable from vacant properties. For the nine months ended September 30, 2010, property operating, maintenance and property taxes decreased by approximately (\$0.5) million, or (2.6%), from \$19.8 million for the nine months ended September 30, 2009 to \$19.3 million for the nine months ended September 30, 2010.

General and administrative expenses remained relatively the same at approximately \$0.6 million for the three months ended September 30, 2010 and 2009. For the nine months ended September 30, 2009 and 2010, general and administrative expenses decreased by approximately (\$0.1) million, or (4.7%), from \$1.7 million to \$1.6 million, respectively. The decrease was primarily the result of lower stock-based compensation expense in 2010.

Real estate depreciation and amortization expense decreased by approximately (\$0.1) million, or (1.0%), from \$5.9 million to \$5.8 million for the three months ended September 30, 2009 and 2010, respectively. Real estate depreciation and amortization expense decreased by approximately (\$0.4) million, or (2.0%), from \$18.0 million to \$17.6 million for the nine months ended September 30, 2009 and 2010, respectively. The decrease resulted because there was no depreciation expense in 2010 with respect to a building for which a lease was terminated in 2009 and all unamortized tenant improvements in that building were expensed at that time.

Equity in Earnings from Unconsolidated Joint Venture

As of September 30, 2010, we held an investment in one R&D building totaling approximately 155,500 rentable square feet through an unconsolidated joint venture, TBI-MWP, in which we acquired a 50% interest from the Berg Group in January 2003. We have a non-controlling limited partnership interest in this joint venture, which we account for using the equity method of accounting. For the three months ended September 30, 2010, we recorded equity in earnings from the unconsolidated joint venture of approximately \$0.05 million compared with equity in earnings of \$0.07 million for the same period in 2009. For the nine-month periods ended September 30, 2010 and 2009, equity in earnings from the unconsolidated joint venture was approximately \$0.27 million and \$0.24 million, respectively. The occupancy rate for the property owned by this joint venture at September 30, 2010 and 2009 was 100%.

Interest and Dividend Income

Interest and dividend income was negligible for the three months ended September 30, 2010 and 2009. Interest and dividend income decreased by approximately (\$1.11) million, or (95.6%), from \$1.16 million to \$0.05 million for the nine months ended September 30, 2009 and 2010, respectively. The decrease was primarily due to an accrual of approximately \$1.0 million in interest income related to the Hellyer Avenue Limited Partnership litigation in 2009 that did not recur in 2010 (see Note 9 above for further discussion of this litigation).

Realized and Unrealized Gain from Investment

Realized and unrealized gain from investment in marketable securities was \$0 and approximately \$4.5 million for the three months ended September 30, 2010 and 2009, respectively. The decrease was due to the sale of all investment in marketable securities in the second quarter of 2010. For each of the nine month periods ended September 30, 2010 and 2009, realized and unrealized gain from investment in marketable securities was approximately \$4.1 million.

Interest Expense

Interest expense decreased by approximately (\$0.04) million, or (0.8%), from \$5.18 million for the three months ended September 30, 2009 to \$5.14 million for the three months ended September 30, 2010. Interest expense (related parties) remained relatively the same at approximately \$0.2 million for the three months ended September 30, 2010 and 2009. Interest expense decreased by approximately (\$2.3) million, or (13.5%), from \$17.1 million for the nine months ended September 30, 2009 to \$14.8 million for the nine months ended September 30, 2010 due to an accrual of approximately \$2.3 million related to the Hellyer Avenue Limited Partnership litigation in 2009 that did not recur in 2010 (see Note 9 above for further discussion of this litigation). Interest expense (related parties) increased by approximately \$0.3 million, or 51.4%, from \$0.5 million for the nine months ended September 30, 2009 to \$0.8 million for the nine months ended September 30, 2010. Total debt outstanding, including debt due related parties, increased by approximately \$18.2 million, or 5.4%, from \$338.9 million as of September 30, 2009 to \$357.1 million as of September 30, 2010 because of a new mortgage note loan obtained in the third quarter of 2010.

Loss from Discontinued Operations

In accordance with the provisions of the Property, Plant, and Equipment Topic of the FASB ASC 360, in the third quarter of 2010 we classified one R&D property as assets held for sale and as discontinued operations. The loss attributable to discontinued operations from this property for each of the three month periods ended September 30, 2010 and 2009 was approximately (\$0.1) million. The loss attributable to discontinued operations from this property for each of the nine month periods ended September 30, 2010 and 2009 was approximately (\$0.3) million.

Net Income Available to Common Stockholders and Net Income Attributable to Noncontrolling Interests

Net income available to common stockholders decreased by approximately (\$1.4) million, or (50.5%), from \$2.8 million for the three months ended September 30, 2009 to \$1.4 million for the three months ended September 30, 2010. Net income attributable to noncontrolling interests decreased by approximately (\$4.4) million, or (51.6%), from \$8.5 million for the three months ended September 30, 2009 to \$4.1 million for the three months ended September 30, 2010. For the nine months ended September 30, 2010 and 2009, net income available to common stockholders was approximately \$6.3 million and \$6.0 million, respectively, and net income attributable to noncontrolling interests was approximately \$19.4 million and \$18.1 million, respectively.

The amount of net income attributable to noncontrolling interests has been calculated by multiplying the net income of the operating partnerships (on a stand-alone basis) by the respective noncontrolling interests ownership percentage. Noncontrolling interests represent the ownership interest of all limited partners in the operating partnerships taken as a whole, which was approximately 79% as of September 30, 2010 and 2009. The increases in net income attributable to noncontrolling interests in the first nine months of 2010 occurred solely as a result of increases in our net income for the periods.

Changes in Financial Condition

The most significant change in our financial condition during the nine months ended September 30, 2010 resulted from the acquisition of one R&D property consisting of approximately 41,400 rentable square feet located in the Silicon Valley for approximately \$3.9 million in cash.

Total stockholders' equity attributable to Mission West Properties, Inc., net, decreased by approximately (\$2.5) million from December 31, 2009. We obtained additional capital from the issuance of 132,000 shares and 10,859 shares of our common stock for the exchange of O.P. units and stock options exercised, respectively, which increased additional paid-in capital by approximately \$1.0 million. Distributions in excess of accumulated earnings was reduced during the most recent quarter by distributions in excess of earnings of approximately (\$3.6) million.

Liquidity and Capital Resources

Excluding the effects of the investment in marketable securities, we anticipate a decrease in operating cash flows from our operating property portfolio in 2010 compared with 2009. We are still experiencing weak demand for our R&D properties in certain areas of the Silicon Valley. If we are unable to lease a significant portion of the approximately 48,000 rentable square feet scheduled to expire during the remainder of 2010, 739,000 rentable square feet scheduled to expire in 2011 or an equivalent amount of our currently available space of approximately 2.6 million rentable square feet, our operating cash flows after 2010 may be affected adversely. We are also subject to risks of decreased occupancy through tenant defaults and bankruptcies and potential reduction in rental rates upon renewal of properties that could result in reduced cash flow from operations instead. Cash flows from lease terminations are non-recurring. To maintain or increase cash flows in the future we must lease our vacant properties.

Our principal sources of liquidity for distributions to stockholders and O.P. unit holders (noncontrolling interests), debt service, leasing costs, capital expenditures and tenant improvements are to come from net cash flow provided by operations and borrowings from our credit facility, borrowings from related parties, and other sources of financing, as required. We expect these sources of liquidity to be adequate to meet projected distributions to stockholders and other presently anticipated liquidity requirements for the remainder of 2010 and all of 2011. We expect to meet our long-term liquidity requirements for the funding of property development, property acquisitions and other material non-recurring capital improvements through cash, long-term secured and unsecured indebtedness, and the issuance of additional equity securities.

As of September 30, 2010, we had approximately \$15.2 million of cash and cash equivalents. Additionally, we had \$17.5 million available under the Heritage Bank of Commerce ("HBC") credit facility.

Distributions

On October 7, 2010, we paid dividends of \$0.15 per share of common stock to all common stockholders of record as of September 30, 2010. On the same date, the operating partnerships paid a distribution of \$0.15 per O.P. unit to all holders of O.P. units. The aggregate dividends and distributions amounted to approximately \$15.8 million.

Distributions are declared at the discretion of our Board of Directors and are subject to actual cash available for distribution, our financial condition, capital requirements and such other factors, as our Board of Directors deems relevant.

Debt

On August 4, 2010, we entered into a fixed rate term agreement and related contracts and instruments for a secured mortgage loan totaling \$40 million from Hartford Life Insurance Company and Hartford Life and Accident Insurance

Company (the "Hartford Loan II"). The proceeds were used primarily to repay the remaining balance of an existing loan with the Berg Group and to provide other working capital needs. The Hartford Loan II bears a fixed annual interest rate of 6.05%, with a 20-year amortization, and matures September 1, 2030, at which time any outstanding principal and interest will be due. Pursuant to the loan agreement, monthly principal and interest installment payments of approximately \$0.3 million are due on the first day of each month. The Hartford Loan II is secured by five properties consisting of approximately 0.5 million rentable square feet. Loan fees and financing costs totaled approximately \$0.5 million, which are amortized over the 20 year loan period.

At September 30, 2010, we had total indebtedness of approximately \$357.2 million, including \$349.3 million of fixed rate mortgage debt and \$7.9 million debt under the Berg Group mortgage note (related parties), as detailed in the table below. The Northwestern, Allianz, Hartford and HBC loans contain certain financial loan and reporting covenants as defined in the loan agreements. As of September 30, 2010, we were in compliance with these loan covenants.

Contractual Obligations

The following table identifies the contractual obligations with respect to the maturities and scheduled principal repayments of our secured debt, unsecured notes, credit facility and scheduled interest payments of our fixed-rate and variable-rate debt at September 30, 2010 and provides information about our operating lease obligations that will impact our liquidity and cash flow in future periods.

	Three	Year Ending December 31,					Thereafter	Total
	Months	2011	2012	2013	2014			
	Remaining							
	2010							
(dollars in thousands)								
Principal payments (1)	\$ 3,666	\$ 15,187	\$ 16,080	\$ 82,485	\$ 12,183	\$ 227,556	\$ 357,157	
Interest payments-fixed rate debt (2)	5,138	20,027	19,133	15,056	13,527	81,659	154,540	
Operating lease obligations (3)	30	30	-	-	-	-	60	
Total	\$ 8,834	\$ 35,244	\$ 35,213	\$ 97,541	\$ 25,710	\$ 309,215	\$ 511,757	

- (1) As of September 30, 2010, 100% of our debt was contractually fixed and 0% of our debt bore interest at variable rates. Our debt obligations are set forth in detail in the table below.
- (2) The information in the table above reflects our projected interest rate obligations for the fixed-rate payments based on the contractual interest rates, interest payment dates and scheduled maturity dates.
- (3) Our operating lease obligations relate to a lease of our corporate office facility from a related party.

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The following table and notes set forth information regarding debt outstanding as of September 30, 2010:

Debt Description	Collateral Properties	Balance (dollars in thousands)	Maturity Date	Interest Rate
Line of Credit:				
Heritage Bank of Commerce	1600 Memorex Drive, Santa Clara, CA 1688 Richard Drive, Santa Clara, CA 1700 Richard Drive, Santa Clara, CA	-	Sept 2011	(1)
Mortgage Note Payable (related parties) (2) :	5300 & 5350 Hellyer Avenue, San Jose, CA	\$ 7,860	Jun 2013	7.65 %
Mortgage Notes Payable (2):				
Hartford Life Insurance Company	5981 Optical Court, San Jose, CA			
Hartford Life and Accident Insurance Company	5500 Hellyer Avenue, San Jose, CA			
Hartford Life and Annuity Insurance Company	5550 Hellyer Avenue, San Jose, CA			
(collectively known as the "Hartford Loan I") (3)	4050 Starboard Drive, Fremont, CA 45738 Northport Loop, Fremont, CA 233 South Hillview Drive, Milpitas, CA 10300 Bubb Road, Cupertino, CA 1230 E. Arques, Sunnyvale, CA 1250-1280 E. Arques, Sunnyvale, CA 1212 Bordeaux Lane, Sunnyvale, CA 2904 Orchard Parkway, San Jose, CA 3236 Scott Blvd, Santa Clara, CA 6311 San Ignacio Avenue, San Jose, CA 6321-6325 San Ignacio Avenue, San Jose, CA 6331 San Ignacio Avenue, San Jose, CA 6341-6351 San Ignacio Avenue, San Jose, CA 3540-3580 Bassett Street, Santa Clara, CA	109,087	Oct 2018	6.21 %

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Hartford Life Insurance Company Hartford Life and Accident Insurance Company (collectively known as the “Hartford Loan II”) (4)	5830-5870 Hellyer Avenue, San Jose, CA 5750 Hellyer Avenue, San Jose, CA 255 Caspian Drive, Sunnyvale, CA 5970 Optical Court, San Jose, CA 3301 Olcott Street, Santa Clara, CA	40,000	Sept 2030	6.05	%
Northwestern Mutual Life Insurance Company (5)	1750 Automation Parkway, San Jose, CA 1756 Automation Parkway, San Jose, CA 1762 Automation Parkway, San Jose, CA 6320 San Ignacio Avenue, San Jose, CA 6540-6541 Via Del Oro, San Jose, CA 6385-6387 San Ignacio Avenue, San Jose, CA 20605-20705 Valley Green Drive, Cupertino, CA 2001 Walsh Avenue, Santa Clara, CA 2220 Central Expressway, Santa Clara, CA 2300 Central Expressway, Santa Clara, CA 2330 Central Expressway, Santa Clara, CA	74,404	Jan 2013	5.64	%
Allianz Life Insurance Company (Allianz Loan I) (6)	5900 Optical Court, San Jose, CA	21,466	Aug 2025	5.56	%
Allianz Life Insurance Company (Allianz Loan II) (6)	5325-5345 Hellyer Avenue, San Jose, CA 1768 Automation Parkway, San Jose, CA 2880 Scott Boulevard, Santa Clara, CA 2890 Scott Boulevard, Santa Clara, CA 2800 Scott Boulevard, Santa Clara, CA 10450-10460 Bubb Road, Cupertino, CA 6800-6810 Santa Teresa Blvd., San Jose, CA	104,340	Aug 2025	5.22	%

6850 Santa Teresa Blvd., San
 Jose, CA
 4750 Patrick Henry Drive, Santa
 Clara, CA

349,297

TOTAL \$ 357,157

- (1) In October 2009, we entered into a change in terms agreement with the Heritage Bank of Commerce (“HBC”) to amend the maturity date to September 15, 2011. The interest rate on the revolving line of credit is the greater of LIBOR plus 1.75% or 4.00% per annum. The interest rate for the HBC line of credit at September 30, 2010 was 4.00%. Costs and fees incurred with obtaining this loan aggregated approximately \$49, which were deferred and amortized over the loan period. The HBC line of credit contains certain financial loan and reporting covenants as defined in the loan agreement, including minimum tangible net worth and debt service coverage ratio. As of September 30, 2010, we were in compliance with these loan covenants.
- (2) Mortgage notes payable and mortgage note payable (related parties) generally require monthly installments of principal and interest ranging from approximately \$96 to \$840 over various terms extending through the year 2030. The weighted average interest rate of the mortgage notes payable and mortgage note payable (related parties) was 5.78% at September 30, 2010.
- (3) The Hartford loan I is payable in monthly installments of approximately \$838, which includes principal (based upon a 20-year amortization) and interest. Costs and fees incurred with obtaining this loan aggregated approximately \$1,058, which were deferred and amortized over the loan period. The Hartford loan I contains certain customary covenants as defined in the loan agreement. As of September 30, 2010, we were in compliance with these loan covenants.
- (4) The Hartford loan II is payable in monthly installments of approximately \$288, which includes principal (based upon a 20-year amortization) and interest. Costs and fees incurred with obtaining this loan aggregated approximately \$457, which were deferred and amortized over the loan period. The Hartford loan II contains certain customary covenants as defined in the loan agreement. As of September 30, 2010, we were in compliance with these loan covenants.
- (5) The Northwestern loan is payable in monthly installments of approximately \$696, which includes principal (based upon a 20-year amortization) and interest. Costs and fees incurred with obtaining this loan aggregated approximately \$675, which were deferred and amortized over the loan period. The Northwestern loan contains certain customary covenants as defined in the loan agreement. As of September 30, 2010, we were in compliance with these loan covenants.
- (6) The Allianz loans are payable in monthly aggregate installments of approximately \$1,017, which includes principal (based upon a 20-year amortization) and interest. Costs and fees incurred with obtaining these loans aggregated approximately \$1,089, which were deferred and amortized over the loan periods. The Allianz loans contain certain customary covenants as defined in the loan agreements. As of September 30, 2010, we were in compliance with these loan covenants.

At September 30, 2010, our debt to total market capitalization ratio, which is computed as our total debt outstanding divided by the sum of total debt outstanding plus the market value of common stock (based upon the closing price of \$6.78 per share on September 30, 2010) on a fully diluted basis, including the conversion of all O.P. units into common stock, was approximately 33.3%. On September 30, 2010, the last trading day in the quarter, total market capitalization was approximately \$1.07 billion.

At September 30, 2010, the outstanding balance remaining under certain notes that we owed to the operating partnerships was approximately \$2.4 million. The due date of these notes has been extended to September 30, 2011. The principal amount of these notes, along with the interest expense, which is interest income to the operating partnerships, is eliminated in consolidation and is not included in the corresponding line items within the condensed consolidated financial statements. However, the interest income earned by the operating partnerships, which is interest expense to us, in connection with this debt, is included in the calculation of noncontrolling interests as reported on the condensed consolidated statement of operations, thereby reducing our net income by this same amount. At present, our only means for repayment of this debt is through distributions that we receive from the operating partnerships that are in excess of the amount of dividends to be paid to our stockholders or by raising additional equity capital.

Historical Cash Flows

Comparison of the nine months ended September 30, 2010 with the nine months ended September 30, 2009

Net cash provided by operating activities for the nine months ended September 30, 2010 was approximately \$72.0 million compared with \$58.7 million for the same period in 2009. Cash flow increased primarily from proceeds received from the sale of our investment in marketable securities in 2010.

Net cash used in investing activities was approximately \$5.5 million and \$0.7 million for the nine months ended September 30, 2010 and 2009, respectively. Cash used in investing activities during the nine months ended September 30, 2010 related principally to the acquisition of one R&D property at 1040-1050 La Avenida Street in Mountain View, California for approximately \$3.9 million. Capital expenditures for real estate improvements were approximately \$1.7 million and \$0.2 million for the nine months ended September 30, 2010 and 2009, respectively.

Net cash used in financing activities was approximately \$52.3 million for the nine months ended September 30, 2010 compared with approximately \$57.5 million for the nine months ended September 30, 2009. During the first nine months of 2010, we financed \$40 million through a new mortgage note loan, financed approximately \$53.0 million in short-term debt from the Berg Group, paid approximately \$97.0 million towards outstanding debt, paid approximately \$0.5 million in financing costs, received approximately \$0.1 million from stock option exercises, paid approximately \$38.0 million of distributions to noncontrolling interests and paid approximately \$9.9 million of dividends to common stockholders. During the same period in 2009, we financed approximately \$29.6 million in short-term debt from the Berg Group, received \$15 million from a loan with our VIE, paid approximately \$48.5 million towards outstanding debt, paid approximately \$42.1 million of distributions to noncontrolling interests and paid approximately \$11.5 million of dividends to common stockholders.

In 2009, we issued multiple notes in the aggregate amount of \$22 million to M&M Real Estate for funds borrowed from restricted cash. The notes bear interest at LIBOR plus 2% and are due December 31, 2010. Approximately \$10.4 million was repaid in 2010. As of September 30, 2010, the remaining balance owed to M&M Real Estate, including accrued interest, was approximately \$12.1 million. This cash is required to be paid to us in any event between now and December 2011 under the terms of the lease termination and assumption agreements with M&M Real Estate and the former tenant under the lease. The principal amount of these notes, along with the interest expense and interest income to the operating partnerships, are eliminated in consolidation and are not included in the corresponding line items within the condensed consolidated financial statements.

Funds From Operations (“FFO”)

FFO is a non-GAAP financial measurement used by real estate investment trusts to measure and compare operating performance. As defined by NAREIT, FFO represents net income (loss), computed in accordance with GAAP, plus non-recurring events other than “extraordinary items” under GAAP, excluding gains and losses from sales of depreciable operating properties, plus real estate related depreciation and amortization, excluding amortization of deferred financing costs and depreciation of non-real estate assets, and after adjustments for joint ventures and unconsolidated partnerships. FFO does include impairment losses for properties held for sale and held for use. Management considers FFO to be an appropriate supplemental measure of our operating and financial performance because when compared year over year, it reflects the impact to operations from trends in occupancy rates, rental rates, operating costs, general and administrative expenses and interest costs, providing a perspective not immediately apparent from net income. In addition, management believes that FFO provides useful information about our financial performance when compared with other REITs because FFO is generally recognized as the industry standard for reporting the operations of REITs. In addition to the disclosure of operating earnings per share, we will continue to use FFO as a measure of our performance. FFO should neither be considered as an alternative for net income as a measure of profitability nor is it comparable to cash flows provided by operating activities determined in accordance with GAAP, nor is FFO necessarily indicative of funds available to meet our cash needs, including the need to make cash distributions to satisfy REIT requirements. For example, FFO is not adjusted for payments of debt principal required under our debt service obligations.

Our definition of FFO also assumes conversion at the beginning of the period of all convertible securities, including noncontrolling interests represented by O.P. Units that might be exchanged for common stock. FFO does not represent the amount available for management’s discretionary use; as such funds may be needed for capital replacement or expansion, debt service obligations or other commitments and uncertainties. Furthermore, FFO is not comparable to similarly entitled items reported by other REITs that do not define FFO exactly as we do.

FFO for the three and nine months ended September 30, 2010 and 2009, as reconciled to net income, are summarized in the following table:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Net income	\$ 5,471	\$ 11,242	\$ 25,655	\$ 24,065
Add:				
Depreciation and amortization (1)	6,410	6,445	19,493	19,975
Less:				
Noncontrolling interests in joint ventures	(111)	(83)	(312)	(177)
FFO	\$ 11,770	\$ 17,604	\$ 44,836	\$ 43,863

- (1) Includes depreciation and amortization of real estate from discontinued operations totaling approximately \$58 for the three months ended September 30, 2010 and 2009 and \$174 for the nine months ended September 30, 2010 and 2009. Includes our portion of depreciation and amortization of real estate and leasing commissions from our unconsolidated joint venture totaling approximately \$60 for the three months ended September 30, 2010 and 2009 and \$179 for the nine months ended September 30, 2010 and 2009. Also includes our amortization of leasing commissions of approximately \$489 and \$464 for the three months ended September 30, 2010 and 2009,

respectively, and \$1,474 and \$1,596 for the nine months ended September 30, 2010 and 2009, respectively. Amortization of leasing commissions is included in the property operating, maintenance and real estate taxes line item in the condensed consolidated statements of operations.

Distribution Policy

Our board of directors determines the amount and timing of distributions to our stockholders. The board of directors will consider many factors prior to making any distributions, including the following:

- the amount of cash available for distribution;
- our ability to refinance maturing debt obligations;
 - our financial condition;
- whether to reinvest funds rather than to distribute such funds;
 - our committed and projected capital expenditures;
- the amount of cash required for new property acquisitions, including acquisitions under existing agreements with the Berg Group;
 - the amount of our annual debt service requirements;
 - prospects of tenant renewals and re-leases of properties subject to expiring leases;
 - cash required for re-leasing activities;
- the annual distribution requirements under the REIT provisions of the federal income tax laws; and
 - such other factors as the board of directors deems relevant.

We cannot assure you that we will be able to meet or maintain our cash distribution objectives.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

We strive to maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives and management necessarily is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As required by SEC Rule 13a-15(b) we conducted an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer, President and Vice President of Finance, of the effectiveness of the design and operation of our disclosure controls and procedures. Based upon that evaluation, the Chief Executive Officer, President and Vice President of Finance concluded that our disclosure controls and procedures (as defined in Rule 13a-15(e) or Rule 15d-15(e)) were effective as of September 30, 2010.

Changes in Internal Control over Financial Reporting

There was no material change in our internal control over financial reporting during the last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II - Other Information

ITEM 1. Legal Proceedings

The discussion of legal proceedings is incorporated herein by reference from Part I “Item 1. – Notes to Condensed Consolidated Financial Statements – Note 9 – Commitments and Contingencies.”

ITEM 1A. Risk Factors

While we attempt to identify, manage and mitigate risks and uncertainties associated with our business to the extent practical under the circumstances, some level of risk and uncertainty will always be present. In addition to the other information contained in this report, you should carefully review the factors discussed under Item 1A of our annual report on Form 10-K for the year ended December 31, 2009 which describes some of the risks and uncertainties associated with our business. These risks and uncertainties have the potential to materially affect our business, financial condition, results of operations, cash flows, and future prospects. Additional risks and uncertainties not presently known to us or that we currently deem immaterial also may impair our business operations.

ITEM 6. Exhibits

- 10.16 Hartford Fixed Rate Term Loan Agreement II
- 10.16.1 Hartford Life Insurance Company Promissory Note II
- 10.16.2 Hartford Life and Accident Insurance Company Promissory Note II
- 10.16.3 Hartford-Mission West Properties, L.P. Deed of Trust, Security Agreement and Fixture Filing II
- 10.16.4 Hartford-Mission West Properties, L.P. I Deed of Trust, Security Agreement and Fixture Filing II
- 10.16.5 Hartford Carveout Indemnity Agreement II
- 10.16.6 Hartford Environmental Indemnity Agreement II
- 31.1 Section 1350 Certificate of CEO
- 31.2 Section 1350 Certificate of President & COO
- 31.3 Section 1350 Certificate of Principal Financial Officer
- 32 Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Signatures

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

Mission West Properties, Inc.
(Registrant)

Date: November 9, 2010

By:/s/ Carl E. Berg
Carl E. Berg
Chief Executive Officer

Date: November 9, 2010

By:/s/ Wayne N. Pham
Wayne N. Pham
Vice President of Finance
(Principal Accounting Officer and Duly Authorized
Officer)

