American Assets Trust, Inc.
Form 10-Q
November 09, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2012

or

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

For the transition period from to

Commission file number: 001-35030

AMERICAN ASSETS TRUST, INC.

(Exact Name of Registrant as Specified in its Charter)

Maryland	**27-3338708**
(State of Organization)	**(IRS Employer Identification No.)**
11455 El Camino Real, Suite 200, San Diego, California	**92130**
(Address of Principal Executive Offices)	**(Zip Code)**

(858) 350-2600

(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. x Yes ¨ No

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post such files). x Yes ¨ No

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

Large Accelerated Filer	¨	Accelerated Filer	¨
Non-Accelerated Filer	x (Do not check if a smaller reporting company)	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 x No

The number of Registrant s common shares outstanding on November 9, 2012 was 39,627,212.

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AMERICAN ASSETS TRUST, INC.

QUARTERLY REPORT ON FORM 10-Q

FOR THE QUARTER ENDED SEPTEMBER 30, 2012

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American Assets Trust, Inc.

Consolidated Balance Sheets

(In Thousands, Except Share Data)

	September 30, 2012 (unaudited)	December 31, 2011
ASSETS		
Real estate, at cost		
Operating real estate	$ 1,917,089	$ 1,659,106
Construction in progress	34,369	3,495
Held for development	14,877	24,675
	1,966,335	1,687,276
Accumulated depreciation	(267,840)	(234,595)
Net real estate	1,698,495	1,452,681
Cash and cash equivalents	34,917	112,723
Restricted cash	10,251	9,216
Marketable securities		28,235
Accounts receivable, net	6,076	6,847
Deferred rent receivable, net	29,392	23,294
Other assets, net	81,806	76,285
TOTAL ASSETS	$ 1,860,937	$ 1,709,281
LIABILITIES AND EQUITY		
LIABILITIES:		
Secured notes payable	$ 964,068	$ 943,479
Line of credit	141,000	
Accounts payable and accrued expenses	33,950	25,476
Security deposits payable	5,482	4,790
Other liabilities and deferred credits	61,140	55,808
Total liabilities	1,205,640	1,029,553
Commitments and contingencies (Note 10)		
EQUITY:		
American Assets Trust, Inc. stockholders equity		
Common stock, $0.01 par value, 490,000,000 shares authorized, 39,316,461 and 39,283,796 shares outstanding at September 30, 2012 and December 31, 2011, respectively	393	393
Additional paid-in capital	656,425	653,645
Accumulated dividends in excess of net income	(46,004)	(28,007)
Total American Assets Trust, Inc. stockholders equity	610,814	626,031
Noncontrolling interests	44,483	53,697
Total equity	655,297	679,728
TOTAL LIABILITIES AND EQUITY	$ 1,860,937	$ 1,709,281

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

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American Assets Trust, Inc.

Consolidated Statements of Income

(Unaudited)

(In Thousands, Except Shares and Per Share Data)

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
REVENUE:				
Rental income	$ 59,915	$ 53,278	$ 169,199	$ 146,860
Other property income	2,921	3,015	8,484	7,416
Total revenue	62,836	56,293	177,683	154,276
EXPENSES:				
Rental expenses	17,024	16,187	48,219	42,720
Real estate taxes	6,301	5,390	17,689	14,800
General and administrative	3,959	3,733	11,716	10,786
Depreciation and amortization	16,432	15,827	46,356	41,916
Total operating expenses	43,716	41,137	123,980	110,222
OPERATING INCOME	19,120	15,156	53,703	44,054
Interest expense	(14,690)	(14,738)	(43,522)	(41,791)
Early extinguishment of debt				(25,867)
Loan transfer and consent fees				(9,019)
Gain on acquisition				46,371
Other income (expense), net	68	(108)	(188)	(179)
INCOME FROM CONTINUING OPERATIONS	4,498	310	9,993	13,569
DISCONTINUED OPERATIONS				
(Loss) income from discontinued operations	(213)	327	(213)	1,119
Gain on sale of real estate property		3,981		3,981
Results from discontinued operations	(213)	4,308	(213)	5,100
NET INCOME	4,285	4,618	9,780	18,669
Net income attributable to restricted shares	(133)	(132)	(396)	(350)
Net loss attributable to Predecessor s noncontrolling interests in consolidated real estate entities				2,458
Net income attributable to Predecessor s controlled owners equity				(16,995)
Net income attributable to unitholders in the Operating Partnership	(1,335)	(1,434)	(3,022)	(1,209)
NET INCOME ATTRIBUTABLE TO AMERICAN ASSETS TRUST, INC. STOCKHOLDERS	$ 2,817	$ 3,052	$ 6,362	$ 2,573
EARNINGS PER COMMON SHARE, BASIC				
Continuing operations	$ 0.08	$	$ 0.17	$ (0.03)
Discontinued operations		0.08		0.10
Basic net income attributable to common stockholders per share	$ 0.08	$ 0.08	$ 0.17	$ 0.07

Weighted average shares of common stock outstanding - basic		38,673,617		38,655,084		38,663,352		36,106,397
EARNINGS PER COMMON SHARE, DILUTED								
Continuing operations	$	0.08	$		$	0.17	$	(0.03)
Discontinued operations				0.08				0.10
Diluted net income attributable to common stockholders per share	$	0.08	$	0.08	$	0.17	$	0.07
Weighted average shares of common stock outstanding - diluted		57,054,425		57,051,173		57,054,425		53,265,648
Dividends declared per common share	$	0.21	$	0.21	$	0.63	$	0.59

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

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American Assets Trust, Inc.

Consolidated Statement of Equity

(Unaudited)

(In Thousands, Except Share Data)

	American Assets Trust, Inc. Stockholders Equity					
	Common Shares					
	Shares	Amount	Additional Paid-in Capital	Accumulated dividends in excess of net income	Noncontrolling Interests - Unitholders in the Operating Partnership	Total
Balance at December 31, 2011	39,283,796	$ 393	$ 653,645	$ (28,007)	$ 53,697	$ 679,728
Net income				6,758	3,022	9,780
Conversion of operating partnership units	24,903		652		(652)	
Issuance of restricted stock	10,015					
Forfeiture of restricted stock	(2,253)					
Dividends declared and paid				(24,755)	(11,584)	(36,339)
Stock-based compensation			2,128			2,128
Balance at September 30, 2012	39,316,461	$ 393	$ 656,425	$ (46,004)	$ 44,483	$ 655,297

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

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American Assets Trust, Inc.

Consolidated Statements of Cash Flows

(Unaudited)

(In Thousands)

	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
OPERATING ACTIVITIES		
Net income	$ 9,780	$ 18,669
Results from discontinued operations	213	(5,100)
Income from continuing operations	9,993	13,569
Adjustments to reconcile income from continuing operations to net cash provided by operating activities:		
Deferred rent revenue and amortization of lease intangibles	(5,521)	(1,639)
Depreciation and amortization	46,356	41,916
Amortization of debt issuance costs and debt fair value adjustments	2,964	2,924
Early extinguishment of debt		25,867
Loan transfer and consent fees		9,019
Gain on acquisition of controlling interests		(46,371)
Stock-based compensation expense	2,128	1,902
Other, net	998	1,774
Changes in operating assets and liabilities		
Change in restricted cash	(2,100)	(848)
Change in accounts receivable	445	(3,262)
Change in other assets	(1,409)	(590)
Change in accounts payable and accrued expenses	2,848	5,689
Change in security deposits and other liabilities	(1,095)	125
Net cash provided by operating activities of continuing operations	55,607	50,075
Net cash (used in) provided by operating activities of discontinued operations	(213)	1,748
Net cash provided by operating activities	55,394	51,823
INVESTING ACTIVITIES		
Acquisition of real estate, net of cash acquired	(253,090)	(227,309)
Capital expenditures	(25,779)	(5,871)
Change in restricted cash	1,066	(1,653)
Cash acquired from acquisition of controlling interests in real estate joint ventures		15,222
Leasing commissions	(2,727)	(1,772)
Purchase of marketable securities		(33,103)
Maturity of marketable securities	4,384	3,502
Deposit on property acquisition	(2,000)	
Sale of marketable securities	23,191	
Net cash used in investing activities of continuing operations	(254,955)	(250,984)
Net cash provided by investing activities of discontinued operations		30,078
Net cash used in investing activities	(254,955)	(220,906)
FINANCING ACTIVITIES		

Issuance of secured notes payable	21,900	84,500
Repayment of secured notes payable	(3,512)	(263,106)
Defeasance costs on repayment of secured notes payable		(24,345)
Proceeds from unsecured line of credit	164,000	
Repayment of unsecured line of credit	(23,000)	
Loan transfer and consent fees paid		(8,350)
Repayment of unsecured notes payable		(38,013)
Repayment of notes payable to affiliates		(19,279)
Debt issuance costs	(932)	(2,961)
Proceeds from issuance of common stock, net		596,541
Proceeds from private placement of common units		5,410
Dividends paid to common stock and unitholders	(36,340)	(34,010)
Deferred offering costs	(361)	
Payments to nonaccredited investors		(6,075)
Distributions to Predecessor s controlling and noncontrolling interests		(39,960)
Net cash provided by financing activities	121,755	250,352
Net (decrease) increase in cash and cash equivalents	(77,806)	81,269
Cash and cash equivalents, beginning of period	112,723	41,953
Cash and cash equivalents, end of period	$ 34,917	$ 123,222

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

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American Assets Trust, Inc.

Notes to Consolidated Financial Statements

September 30, 2012

(Unaudited)

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Business and Organization

American Assets Trust, Inc. (which may be referred to in these financial statements as the Company, we, us, or our) is a Maryland corporation formed on July 16, 2010 that did not have any operating activity until the consummation of our initial public offering (the Offering) and the related acquisition of certain assets of our Predecessor (as defined below) on January 19, 2011. The Company is the sole general partner of American Assets Trust, L.P., a Maryland limited partnership formed on July 16, 2010 (the Operating Partnership). The Company s operations are carried on through our Operating Partnership and its subsidiaries, including our taxable REIT subsidiary. Since the formation of our Operating Partnership, the Company has controlled our Operating Partnership as its general partner and has consolidated its assets, liabilities and results of operations.

In connection with the Offering, on January 19, 2011 the following transactions were completed:

We issued a total of 31,625,000 shares of our common stock at $20.50 per share.

We acquired, through a series of merger and contribution transactions (the Formation Transactions, as more fully described below), certain assets of our Predecessor and certain other entities. In exchange for such assets, the prior investors in such assets that were accredited investors were issued a total of 7,030,084 shares of our common stock and 18,145,039 common units of limited partnership interests in our Operating Partnership (common units), with an aggregate value of approximately $516.1 million, and non-accredited prior investors were paid a total of approximately $6.1 million in cash from the net proceeds of the Offering.

We entered into a $250.0 million revolving credit facility (the credit facility) with an accordion feature to increase availability to $400.0 million under specified circumstances.

We repaid $342.0 million of indebtedness (including $24.3 million of defeasance costs) and paid $10.8 million, net of $0.7 million prepaid by our Predecessor, for loan transfer and consent fees and credit facility origination fees from the net proceeds of the Offering.

The net proceeds from the Offering were approximately $594.6 million, net of $1.9 million of offering costs prepaid by our Predecessor, including the underwriters overallotment option which was exercised in full (after deducting the underwriting discount and commissions and expenses of the Offering and Formation Transactions). We contributed the net proceeds of the Offering to our Operating Partnership in exchange for common units.

Our Predecessor is not a legal entity but rather a combination of entities whose assets included entities owned and/or controlled by Ernest S. Rady and his affiliates, including the Ernest Rady Trust U/D/T March 13, 1983 (the Rady Trust), which in turn owned (1) controlling interests in entities owning 17 properties and the property management business of American Assets, Inc. (AAI) (the controlled entities), and (2) noncontrolling interests in entities owning four properties (the noncontrolled entities) (the assets described at (1) and (2) are the Acquired Assets, and do not include our Predecessor s noncontrolling 25% ownership interest in Novato FF Venture, LLC, the entity that owns the Fireman s Fund Headquarters in Novato, California). The Formation Transactions included the acquisition by our Operating Partnership of the (a) Acquired Assets, (b) the entities that own Waikiki Beach Walk (a mixed-use property consisting of a retail portion and a hotel portion) (the Waikiki Beach Walk entities) and (c) the entities that own Solana Beach Towne Centre and Solana Beach Corporate Centre (the Solana Beach Centre entities) (including our Predecessor s ownership interest in these entities).

The Formation Transactions enabled us to (1) consolidate the ownership of our property portfolio under our Operating Partnership, (2) succeed to the property management business of AAI, (3) facilitate the Offering, and (4) qualify as a real estate investment trust (a REIT) for U.S. federal income tax purposes commencing with the taxable year ending December 31, 2011. As a result of the Formation Transactions, we are a vertically integrated and self-administered REIT with approximately 130 employees providing substantial in-house expertise in asset management, property management, property development, leasing, tenant improvement construction, acquisitions, repositioning, redevelopment and financing.

We determined that our Predecessor was the acquirer for accounting purposes, and therefore the contribution or acquisition by merger of interests in the controlled entities was considered a transaction between entities under common control since our Executive Chairman, Ernest S. Rady or his affiliates, including the Rady Trust, owned the controlling interest in each of the entities comprising our Predecessor, which, in turn, owned a controlling interest in each of the controlled entities. As a result, the acquisition of interests in each of the controlled entities was recorded at our historical cost. The contribution or

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acquisition by merger of interests in certain of the noncontrolled entities, which include the Waikiki Beach Walk entities and the Solana Beach Centre entities (including our Predecessor s ownership interest in these noncontrolled entities), was accounted for as an acquisition under the acquisition method of accounting and recognized at the estimated fair value of acquired assets and assumed liabilities on the date of such contribution or acquisition.

Since these transactions occurred on January 19, 2011, the financial condition and results of operations for the entities acquired by us in connection with the Offering and related Formation Transactions are not included in certain historical financial statements. Our results of operations for the nine months ended September 30, 2011 reflect the financial condition and results of operation for our Predecessor together with the entities we acquired at the time of the Offering, namely, the Waikiki Beach Walk entities and the Solana Beach Centre entities, as well as entities acquired subsequent to the Offering. We have included the results of operations for the acquired entities in our consolidated statements of operations from the date of acquisition.

As of September 30, 2012, we owned or had a controlling interest in 23 office, retail, multifamily and mixed-use operating properties, the operations of which we consolidate. Additionally, as of September 30, 2012, we owned land at five of our properties that we classify as held for development and/or construction in progress. A summary of the properties owned by us is as follows:

Retail

Carmel Country Plaza

Carmel Mountain Plaza

South Bay Marketplace

Rancho Carmel Plaza

Lomas Santa Fe Plaza

Solana Beach Towne Centre

Del Monte Center

The Shops at Kalakaua

Waikele Center

Alamo Quarry Market

Office

Torrey Reserve Campus

Solana Beach Corporate Centre

160 King Street

The Landmark at One Market

One Beach Street

First & Main

Lloyd District Portfolio

City Center Bellevue

Multifamily

Loma Palisades

Imperial Beach Gardens

Mariner s Point

Santa Fe Park RV Resort

Mixed-Use

Waikiki Beach Walk Retail and Embassy Suites™ Hotel

Held for Development and Construction in Progress

Solana Beach Corporate Centre Land

Solana Beach Highway 101 Land

Sorrento Pointe Land

Torrey Reserve Land

Lloyd District Portfolio Land

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Basis of Presentation

Our consolidated financial statements include the accounts of the Company, our Operating Partnership and our subsidiaries. The equity interests of other investors in our Operating Partnership are reflected as noncontrolling interests.

All significant intercompany transactions and balances are eliminated in consolidation.

In August 2011, we sold Valencia Corporate Center. We have reclassified our financial statements for all periods prior to the sale to reflect Valencia Corporate Center as discontinued operations. Unless noted otherwise, discussions in these notes pertain to our continuing operations.

The accompanying consolidated financial statements of the Company have been prepared in accordance with the rules applicable to Form 10-Q and include all information and footnotes required for interim financial statement presentation, but do not include all disclosures required under accounting principles generally accepted in the United States (GAAP) for annual financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments, except as otherwise noted) considered necessary for a fair presentation have been included.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that in certain circumstances affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities, and revenues and expenses. These estimates are prepared using management s best judgment, after considering past, current and expected events and economic conditions. Actual results could differ from these estimates.

Any reference to the number of properties and square footage are unaudited and outside the scope of our independent registered public accounting firm s audit of our financial statements in accordance with the standards of the United States Public Company Accounting Oversight Board.

Consolidated Statements of Cash Flows Supplemental Disclosures

The following table provides supplemental disclosures related to the Consolidated Statements of Cash Flows (in thousands):

	Nine Months Ended September 30, 2012	2011
Supplemental cash flow information		
Total interest costs incurred	$ 43,983	$ 41,791
Interest capitalized	$ 461	$
Interest expense	$ 43,522	$ 41,791
Cash paid for interest, net of amounts capitalized	$ 40,527	$ 39,158
Cash paid for income taxes	$ 1,210	$ 55
Supplemental schedule of noncash investing and financing activities		
Accounts payable and accrued liabilities for construction in progress	$ 5,635	$ 1,525
Assumption of debt upon acquisition	$	$ 268,008
Assumption of notes to affiliates upon acquisition	$	$ 14,824
Acquisition of working capital deficit, net of cash	$	$ (4,175)
Distribution of investment in joint venture not acquired	$	$ 11,480

Issuance of common shares and units for acquisition of properties	$		$	33,854
Notes receivable from affiliate settled in common units	$		$	21,797
Notes payable to affiliates settled in common units	$		$	828
Reduction to capital for prepaid Offering costs	$		$	1,974
Transfer taxes accrued at time of Offering	$		$	6,556

Significant Accounting Policies

We describe our significant accounting policies in Note 1 to the consolidated financial statements in Item 8 of our Annual Report on Form 10-K for the year ended December 31, 2011. There have been no changes to our significant accounting policies during the nine months ended September 30, 2012.

Segment Information

Segment information is prepared on the same basis that our management reviews information for operational decision-making purposes. We operate in four business segments: the acquisition, redevelopment, ownership and management of retail real estate, office real estate, multifamily real estate and mixed-use real estate. The products for our retail segment primarily include rental of retail space and other tenant services, including tenant reimbursements, parking and storage space rental. The products for our office segment primarily include rental of office space and other tenant services, including tenant reimbursements, parking and storage space rental. The products for our multifamily segment include rental of apartments and other tenant services. The products of our mixed-use segment include rental of retail space and other tenant services, including tenant reimbursements, parking and storage space rental and operation of a 369-room all-suite hotel.

Reclassifications

Certain items in the consolidated financial statements for prior periods have been reclassified to conform to current classifications.

Recent Accounting Pronouncements

In May 2011, the FASB issued ASU No. 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs* (ASU 2011-04), which amended ASC Topic 820, *Fair Value Measurement.* ASU 2011-04 clarifies the application of certain existing fair value measurement guidance and expands the disclosures for fair value measurements that are estimated using significant unobservable (Level 3) inputs. ASU 2011-04 is effective for annual and interim reporting periods beginning on or after December 15, 2011. The new guidance is to be adopted prospectively and early adoption is not permitted. The adoption of ASU 2011-04 did not have a significant impact on our financial position, results of operations or cash flows.

In June 2011, the FASB issued ASU No. 2011-05, *Presentation of Comprehensive Income* (ASU 2011-05), which amended ASC Topic 220, *Comprehensive Income.* ASU 2011-05 eliminates the option to present components of other comprehensive income as part of the statement of changes in equity and requires that all non owner changes in equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. ASU 2011-05 requires retrospective application and has been effective for interim and annual reporting periods beginning after December 15, 2011. The adoption of ASU 2011-05 did not have significant impact on our disclosures of comprehensive income, since we do not have other comprehensive income.

NOTE 2. REAL ESTATE

Acquisitions

On January 24, 2012, we acquired One Beach Street, consisting of approximately 97,000 rentable square feet in a 3-story fully renovated historic office building located along the Embarcadero in San Francisco s North Waterfront District. The purchase price was approximately $36.5 million, excluding closing costs of approximately $0.02 million. The identified intangible assets and liabilities are being amortized over a weighted average life of 7.0 years.

On August 21, 2012, we acquired City Center Bellevue, a 27-story LEED-EB Gold certified office tower, consisting of approximately 497,000 square feet, located in Bellevue, Washington. The purchase price was approximately $228.8 million, excluding closing costs of approximately $0.1 million. Additionally, we received credits to our purchase price of approximately $6.9 million that primarily relate to outstanding tenant improvement obligations and rent abatements. The identified intangible assets and liabilities are being amortized over a weighted average life of 5.8 years.

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The fair values assigned to identifiable intangible assets acquired were based on estimates and assumptions determined by management. Using information available at the time the acquisition closed, we allocated the total consideration to tangible assets and liabilities and identified intangible assets and liabilities. We may adjust the purchase price allocation after obtaining more information about asset valuations and liabilities assumed. The allocation of the purchase price for each of One Beach Street and City Center Bellevue is as follows (in thousands):

	One Beach Street	City Center Bellevue	Total
Land	$ 15,332	$ 25,135	$ 40,467
Building	16,764	185,653	202,417
Land improvements	30	154	184
Tenant improvements	1,223	5,191	6,414
Total real estate	33,349	216,133	249,482
Lease intangibles	4,141	11,870	16,011
Prepaid expenses and other assets	1	2,596	2,597
Total assets	$ 37,491	$ 230,599	$ 268,090
Accounts payable and accrued expenses	$ 94	$ 456	$ 550
Security deposits payable	75	740	815
Lease intangibles	1,382	8,733	10,115
Other liabilities and deferred credits	22	497	519
Total liabilities	$ 1,573	$ 10,426	$ 11,999

We have included the results of operations for One Beach Street and City Center Bellevue in our consolidated statements of income from the date of acquisition. For the period of acquisition through September 30, 2012, One Beach Street contributed $2.9 million to total revenue, $0.7 million to operating expenses, $2.2 million to operating income and $0.6 million to net income. For the period of acquisition through September 30, 2012, City Center Bellevue contributed $2.2 million to total revenue, $0.4 million to operating expenses, $1.8 million to operating income and $0.1 million to net income.

On August 28, 2012, we entered into an agreement to acquire Geary Marketplace, a newly constructed, approximately 35,000 square foot, 100% leased, grocery anchored shopping center in Walnut Creek, California. The purchase price is approximately $21.0 million. The acquisition is expected to close early in the first quarter of 2013, subject to customary closing conditions.

Pro Forma Financial Information

The unaudited financial information in the table below summarizes the combined results of operations of One Beach Street and City Center Bellevue with the historical results of operations of the Company, as though the entities were acquired on January 1, 2011. The pro forma financial information for the nine months ended September 30, 2011 also includes the pro forma results of operations of the Waikiki Beach Walk entities, Solana Beach Centre entities, First & Main, Lloyd District Portfolio and Solana Beach-Highway 101, each of which were acquired at various times during 2011. The pro forma financial information is presented for informational purposes only and is not indicative of the results of operations that would have been achieved if the acquisitions had taken place on January 1, 2011. The pro forma financial information includes adjustments to depreciation expense for acquired property and equipment, adjustments to amortization charges for acquired intangible assets and liabilities, adjustments to straight-line rent revenue and the removal of the gain on acquisition of the controlling interests of the Solana Beach Centre entities and Waikiki Beach Walk entities for the nine months ended September 30, 2011.

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The following table summarizes the unaudited pro forma financial information (in thousands):

	Nine Months Ended September 30, 2012		Nine Months Ended September 30, 2011	
	As Reported	Pro Forma	As Reported	Pro Forma
Total revenue	$ 177,683	$ 186,776	$ 154,276	$ 179,780
Total operating expenses	123,980	134,068	110,222	133,590
Operating income	53,703	52,708	44,054	46,190
Net income (loss)	$ 9,993	$ 9,126	$ 13,569	$ (31,199)[(1)]

(1) The net loss for the nine months ended September 30, 2011 includes one-time expenses for the early extinguishment of debt and loan transfer and consent fees but excludes the gain on acquisition of the controlling interests in the Solana Beach Centre entities and the Waikiki Beach Walk entities.

Dispositions

On August 30, 2011, we sold Valencia Corporate Center and determined that the property was a discontinued operation in the third quarter of 2011. During the third quarter of 2012, we received a supplemental tax billing related to Valencia Corporate Center for approximately $0.3 million, which we recorded against related reserves. The net tax billing of approximately $0.2 million is recorded in discontinued operations.

NOTE 3. ACQUIRED IN-PLACE LEASES AND ABOVE/BELOW MARKET LEASES

The following summarizes our acquired lease intangibles and leasing costs, which are included in other assets and other liabilities and deferred credits, as of September 30, 2012 and December 31, 2011 (in thousands):

	September 30, 2012	December 31, 2011
In-place leases	$ 72,853	$ 59,812
Accumulated amortization	(36,806)	(30,924)
Above market leases	32,910	42,428
Accumulated amortization	(20,114)	(25,657)
Acquired lease intangible assets, net	$ 48,843	$ 45,659
Below market leases	$ 80,263	$ 70,332
Accumulated accretion	(25,470)	(21,715)
Acquired lease intangible liabilities, net	$ 54,793	$ 48,617

We recorded in-place leases of $11.7 million, above market leases of $0.1 million, and below market leases of $8.7 million related to our acquisition of City Center Bellevue during the third quarter of 2012. The identified intangible assets and liabilities for City Center Bellevue are being amortized over a weighted average life of 5.8 years.

NOTE 4. MARKETABLE SECURITIES

Our portfolio of marketable securities was comprised of debt securities that were classified as trading securities. Our marketable securities consisted of investments in mortgage-backed securities issued by the Government National Mortgage Association (GNMA securities). We reported our trading securities at fair value, using prices provided by independent market participants that were based on observable inputs using market-based valuation techniques (Level 2 of the fair value hierarchy-see Note 5). On August 20, 2012, we sold all of our outstanding GNMA securities with a realized loss of $0.7 million for the nine months ended September 30, 2012. For the nine months ended September 30, 2011, gains and losses resulting from the mark-to-market of these securities were recognized as unrealized gains or losses in income. Unrealized (losses) and gains in our statement of income for the nine months ended September 30, 2011 were insignificant and included in other income (expense).

NOTE 5. FAIR VALUE OF FINANCIAL INSTRUMENTS

A fair value measurement is based on the assumptions that market participants would use in pricing an asset or liability. The hierarchy for inputs used in measuring fair value is as follows:

1. Level 1 Inputs quoted prices in active markets for identical assets or liabilities

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2. Level 2 Inputs observable inputs other than quoted prices in active markets for identical assets and liabilities

3. Level 3 Inputs unobservable inputs

Except as disclosed below, the carrying amounts of our financial instruments approximate their fair value. Financial assets and liabilities whose fair values we measure on a recurring basis using Level 2 inputs consist of GNMA securities and our deferred compensation liability. We measure the fair values of these assets and liability based on prices provided by independent market participants that are based on observable inputs using market-based valuation techniques.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, for disclosure purposes, the level within which the fair value measurement is categorized is based on the lowest level input that is significant to the fair value measurement.

The fair value of our secured notes payable is sensitive to fluctuations in interest rates. Discounted cash flow analysis (Level 2) is generally used to estimate the fair value of our secured notes payable, using rates ranging from 3.0% to 8.5%.

Considerable judgment is necessary to estimate the fair value of financial instruments. The estimates of fair value presented herein are not necessarily indicative of the amounts that could be realized upon disposition of the financial instruments. A summary of the carrying amount and fair value of our financial instruments, all of which are based on Level 2 inputs, is as follows (in thousands):

	September 30, 2012		December 31, 2011	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Marketable securities	$	$	$ 28,235	$ 28,235
Secured notes payable	964,068	1,003,699	943,479	974,273
Credit facility	141,000	141,000		
Deferred compensation liability	604	604	520	520

NOTE 6. OTHER ASSETS

Other assets consist of the following (in thousands):

	September 30, 2012	December 31, 2011
Leasing commissions, net of accumulated amortization of $17,107 and $14,722, respectively	$ 19,906	$ 18,207
Acquired above market leases, net	12,796	16,771
Acquired in-place leases, net	36,047	28,888
Lease incentives, net of accumulated amortization of $2,128 and $1,850, respectively	1,573	1,850
Other intangible assets, net of accumulated amortization of $4,208 and $3,885, respectively	973	987
Debt issuance costs, net of accumulated amortization of $2,476 and $2,509, respectively	3,561	3,392
Purchase deposit	2,000	3,000
Prepaid expenses, deposits, and other	4,950	3,190
Total other assets	$ 81,806	$ 76,285

Lease incentives are amortized over the term of the related lease and included as a reduction of rental income in the statement of income. The purchase deposit at December 31, 2011 relates to the acquisition of One Beach Street in San Francisco, California, which was completed on January 24, 2012 (Note 2). The purchase deposit at September 30, 2012 relates to the pending acquisition of Geary Marketplace in Walnut Creek, California (Note 2).

NOTE 7. OTHER LIABILITIES AND DEFERRED CREDITS

Other liabilities and deferred credits consist of the following (in thousands):

	September 30, 2012	December 31, 2011
Acquired below market leases, net	$ 54,793	$ 48,617
Prepaid rent and deferred revenue	4,538	5,008
Deferred rent expense and lease intangible	1,042	1,122
Deferred compensation	604	520
Straight-line rent liability	124	433
Other liabilities	39	108
Total other liabilities and deferred credits	$ 61,140	$ 55,808

Straight-line rent liability relates to leases which have rental payments that decrease over time or one-time upfront payments for which the rental revenue is deferred and recognized on a straight-line basis.

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NOTE 8. DEBT

The following is a summary of our total secured notes payable outstanding as of September 30, 2012 and December 31, 2011 (in thousands):

	Principal Balance as of		Stated Interest Rate as of	
Description of Debt	**September 30, 2012**	**December 31, 2011**	**September 30, 2012**	**Stated Maturity Date**
Alamo Quarry Market [(1)(2)]	$ 94,482	$ 96,027	5.67%	January 8, 2014
160 King Street [(3)]	30,214	31,412	5.68%	May 1, 2014
Waikele Center [(4)]	140,700	140,700	5.15%	November 1, 2014
The Shops at Kalakaua [(4)]	19,000	19,000	5.45%	May 1, 2015
The Landmark at One Market [(2)(4)]	133,000	133,000	5.61%	July 5, 2015
Del Monte Center [(4)]	82,300	82,300	4.93%	July 8, 2015
First & Main [(4)]	84,500	84,500	3.97%	July 1, 2016
Imperial Beach Gardens [(4)]	20,000	20,000	6.16%	September 1, 2016
Mariner s Point [(4)]	7,700	7,700	6.09%	September 1, 2016
South Bay Marketplace [(4)]	23,000	23,000	5.48%	February 10, 2017
Waikiki Beach Walk Retail [(4)]	130,310	130,310	5.39%	July 1, 2017
Solana Beach Corporate Centre III-IV [(5)]	37,302	37,330	6.39%	August 1, 2017
Loma Palisades [(4)]	73,744	73,744	6.09%	July 1, 2018
One Beach Street [(4)]	21,900		3.94%	April 1, 2019
Torrey Reserve North Court [(1)]	21,727	21,921	7.22%	June 1, 2019
Torrey Reserve VCI, VCII, VCIII [(1)]	7,316	7,380	6.36%	June 1, 2020
Solana Beach Corporate Centre I-II [(1)]	11,676	11,788	5.91%	June 1, 2020
Solana Beach Towne Centre [(1)]	38,922	39,293	5.91%	June 1, 2020
	977,793	959,405		
Unamortized fair value adjustment	(13,725)	(15,926)		
Total Secured Notes Payable Outstanding	$ 964,068	$ 943,479		

(1) Principal payments based on a 30-year amortization schedule.
(2) Maturity Date is the earlier of the loan maturity date under the loan agreement, or the Anticipated Repayment Date as specifically defined in the loan agreement, which is the date after which substantial economic penalties apply if the loan has not been paid off.
(3) Principal payments based on a 20-year amortization schedule.
(4) Interest only.

(5) Loan was interest only through August 2012. Beginning in September 2012, principal payments are based on a 30-year amortization schedule.

On March 29, 2012, we entered into a seven-year non-recourse mortgage loan with PNC Bank, National Association with an original principal amount of $21.9 million. The loan is secured by a first-priority deed of trust on One Beach Street and an assignment of all leases, rents and security deposits relating to One Beach Street. The loan has a maturity date of April 1, 2019, bears interest at a fixed rate per annum of 3.94% and is interest only.

Certain loans require us to comply with various financial covenants. As of September 30, 2012, we were in compliance with all loan covenants.

Credit Facility

On January 19, 2011, in connection with the Offering, we entered into a credit facility pursuant to which a group of lenders provided commitments for a revolving credit facility allowing borrowings of up to $250.0 million. At September 30, 2012, our maximum allowable borrowing amount was $219.4 million, of which $141.0 million was outstanding. The credit facility has an accordion feature that may allow us to increase the availability thereunder up to a maximum of $400.0 million,

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subject to meeting specified requirements and obtaining additional commitments from lenders. The credit facility bears interest at the rate of either the applicable LIBOR or a base rate, in each case plus a margin that will vary depending on our leverage ratio. For the three and nine months ended September 30, 2012, we incurred approximately $0.3 million of interest expense on amounts drawn on our credit facility. The amount available for us to borrow under the credit facility is subject to the net operating income of our properties that form the borrowing base of the facility and a minimum implied debt yield of such properties.

On March 7, 2011, the credit facility was amended to allow us or our Operating Partnership to purchase GNMA securities with maturities of up to 30 years. On January 10, 2012, the credit facility was amended a second time to (1) extend the maturity date to January 10, 2016 (with a one-year extension option), (2) decrease the applicable interest rates and (3) modify certain financial covenants contained therein. On September 7, 2012, the credit facility was amended a third time to allow the Company s consolidated total secured indebtedness to be up to 55% of our secured total asset value for the period commencing upon the date that a material acquisition (generally, greater than $100 million) is consummated through and including the last day of the third fiscal quarter that follows such date.

The credit facility includes a number of customary financial covenants, including:

- a maximum leverage ratio (defined as total indebtedness net of certain unrestricted cash and cash equivalents to total asset value) of 60%,
- a minimum fixed charge coverage ratio (defined as consolidated earnings before interest, taxes, depreciation and amortization to consolidated fixed charges) of 1.50x,
- a maximum secured leverage ratio (defined as total secured indebtedness to secured total asset value) of up to 55% in certain circumstances,
- a minimum tangible net worth equal to at least 75% of our tangible net worth at January 19, 2011, plus 85% of the net proceeds of any additional equity issuances (other than additional equity issuances in connection with any dividend reinvestment program), and
- a $35.0 million limit on the maximum principal amount of recourse indebtedness we may have outstanding at any time, other than under the credit facility.

The credit facility provides that our annual distributions may not exceed the greater of (1) 95.0% of our funds from operations or (2) the amount required for us to (a) qualify and maintain our REIT status and (b) avoid the payment of federal or state income or excise tax. If certain events of default exist or would result from a distribution, we may be precluded from making distributions other than those necessary to qualify and maintain our status as a REIT.

We and certain of our subsidiaries guarantee the obligations under the credit facility, and certain of our subsidiaries pledged specified equity interests in our subsidiaries as collateral for our obligations under the credit facility.

As of September 30, 2012, we were in compliance with all credit facility covenants.

NOTE 9. EQUITY

Noncontrolling Interests

Noncontrolling interests in our Operating Partnership are interests in the Operating Partnership that are not owned by us. Noncontrolling interests consisted of 18,371,186 common units (the noncontrolling common units), and represented approximately 32% of the ownership interests in our Operating Partnership at September 30, 2012. Common units and shares of our common stock have essentially the same economic characteristics in that common units and shares of our common stock share equally in the total net income or loss distributions of our Operating Partnership. Investors who own common units have the right to cause our Operating Partnership to redeem any or all of their common units for cash equal to the then-current market value of one share of our common stock, or, at our election, shares of our common stock on a one-for-one basis.

During the nine months ended September 30, 2012, approximately 24,903 common units were converted into shares of our common stock at an average price per share of $26.21.

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Dividends

The following table lists the dividends declared and paid on our shares of common stock and noncontrolling common units during the nine months ended September 30, 2012:

Period	Amount per Share/Unit	Period Covered	Dividend Paid Date
First Quarter 2012	$ 0.21	January 1, 2012 to March 31, 2012	March 30, 2012
Second Quarter 2012	$ 0.21	April 1, 2012 to June 30, 2012	June 29, 2012
Third Quarter 2012	$ 0.21	July 1, 2012 to September 30, 2012	September 28, 2012

Taxability of Dividends

Earnings and profits, which determine the taxability of distributions to stockholders and holders of common units, may differ from income reported for financial reporting purposes due to the differences for federal income tax purposes in the treatment of loss on extinguishment of debt, revenue recognition and compensation expense and in the basis of depreciable assets and estimated useful lives used to compute depreciation.

Stock-Based Compensation

Concurrently with the closing of the Offering, we made grants of restricted shares of our common stock to certain executive officers pursuant to the terms of their employment agreements. These awards were made pursuant to our 2011 Equity Incentive Award Plan (the 2011 Plan) and are subject to either timing-based vesting or performance-based vesting. Those awards subject to time-based vesting will vest, subject to the recipient s continued employment, in two substantially equal installments on each of the third and fourth anniversaries of the date of grant. The vesting of those restricted stock awards subject to performance-based vesting is based on the achievement of absolute and relative total shareholder return hurdles over a three-year performance period, commencing on January 19, 2011. Following the completion of the three-year performance period, our compensation committee will determine the number of shares to which the executive officer is entitled based on our performance relative to the performance hurdles set forth in the restricted stock award agreement he entered into in connection with his initial award grant. These shares will then vest in two substantially equal installments, with the first installment vesting on the third anniversary of the date of grant and the second installment vesting on the fourth anniversary of the date of grant, subject to the executive officer s continued employment on those dates.

We granted each of our non-employee directors restricted shares of our common stock pursuant to the 2011 Plan, either concurrently with the closing of the Offering or at the time the director was formally appointed to our board of directors (the Board). Additionally, on July 10, 2012, we granted a total of 8,015 restricted shares of our common stock to members of our Board. These awards of restricted stock will vest ratably as to one-third of the shares granted on each of the first three anniversaries of the date of grant, subject to the director s continued service on our Board pursuant to our independent director compensation policy.

On March 16, 2011, we granted a total of 123,950 restricted shares of our common stock to certain other employees, and on January 19, 2012, we granted an additional 2,000 restricted shares of our common stock to employees, all pursuant to the 2011 Plan. These shares are subject to performance-based vesting, with substantially the same terms described above.

For the performance-based stock awards, the fair value of the awards was estimated using a Monte Carlo Simulation model. Our stock price, along with the stock prices of a group of peer REITs, is assumed to follow the Multivariate Geometric Brownian Motion Process. Multivariate Geometric Brownian Motion is a common assumption when modeling in financial markets, as it allows the modeled quantity (in this case, the stock price) to vary randomly from its current value and take any value greater than zero. The volatilities of the returns on the stock price of the Company and the group of REITs were estimated based on a three year look-back period. The expected growth rate of the stock prices over the derived service period of the employee is determined with consideration of the risk free rate as of the grant date. For the restricted stock grants that are time-vesting, we estimate the stock compensation expense based on the fair value of the stock at the grant date.

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The following table summarizes the activity of restricted stock awards during the nine months ended September 30, 2012:

	Units	Weighted Average Grant Date Fair Value
Nonvested at January 1, 2012	628,712	$ 15.43
Granted	10,015	22.50
Vested	(3,252)	20.49
Forfeited	(2,253)	12.52
Nonvested at September 30, 2012	633,222	$ 15.64

We recognize noncash compensation expense ratably over the vesting period, and accordingly, we recognized $2.1 million and $1.9 million in noncash compensation expense for the nine months ended September 30, 2012 and 2011, respectively, which is included in general and administrative expense on the consolidated statements of income. Unrecognized compensation expense was $5.1 million at September 30, 2012.

Earnings Per Share

We have calculated earnings per share (EPS) under the two-class method. The two-class method is an earnings allocation methodology whereby EPS for each class of common stock and participating security is calculated according to dividends declared and participation rights in undistributed earnings. For the three and nine months ended September 30, 2012, we had a weighted average of approximately 632,438 and 628,240 unvested shares outstanding, respectively, which are considered participating securities. Therefore, we have allocated our earnings for basic and diluted EPS between common shares and unvested shares.

Diluted EPS is calculated by dividing the net income applicable to common stockholders for the period by the weighted average number of common and dilutive instruments outstanding during the period using the treasury stock method. For the three and nine months ended September 30, 2012, diluted shares exclude incentive restricted stock as these awards are considered contingently issuable. Additionally, the unvested restricted stock awards subject to time vesting are anti-dilutive for all periods presented and accordingly, have been excluded from the weighted average common shares used to compute diluted EPS.

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The computation of basic and diluted EPS is presented below (dollars in thousands, except share and per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
NUMERATOR				
Income from continuing operations	$ 4,498	$ 310	$ 9,993	$ 13,569
Less: Net income attributable to restricted shares	(133)	(132)	(396)	(350)
Plus: Loss from continuing operations attributable to Predecessor s noncontrolling interests in consolidated real estate entities				2,454
Less: Income from continuing operations attributable to Predecessor s controlled owners equity				(17,009)
Less: (Income) loss from continuing operations attributable to unitholders in the Operating Partnership	(1,403)	(57)	(3,090)	427
Income (loss) from continuing operations attributable to American Assets Trust, Inc. common stockholders basic	2,962	121	6,507	(909)
Plus: Results from discontinued operations attributable to American Assets Trust, Inc. common stockholders	(145)	2,931	(145)	3,482
Net income attributable to common stockholders basic	$ 2,817	$ 3,052	$ 6,362	$ 2,573
Income (loss) from continuing operations attributable to American Assets Trust, Inc. common stockholders basic	$ 2,962	$ 121	$ 6,507	$ (909)
Plus: Income (loss) from continuing operations attributable to unitholders in the Operating Partnership	1,403	57	3,090	(427)
Income (loss) from continuing operations attributable to common stockholders diluted	4,365	178	9,597	(1,336)
Plus: Results from discontinued operations attributable to American Assets Trust, Inc. common stockholders	(145)	2,931	(145)	3,482
Plus: Results from discontinued operations attributable to unitholders in the Operating Partnership	(68)	1,377	(68)	1,636
Net income attributable to common stockholders diluted	$ 4,152	$ 4,486	$ 9,384	$ 3,782
DENOMINATOR				
Weighted average common shares outstanding basic	38,673,617	38,655,084	38,663,352	36,106,397
Effect of dilutive securities conversion of Operating Partnership units	18,380,808	18,396,089	18,391,073	17,159,251

Weighted average common shares outstanding diluted	57,054,425	57,051,173	57,054,425	53,265,648
EARNINGS (LOSS) PER COMMON SHARE-BASIC				
Continuing operations	$ 0.08	$	$ 0.17	$ (0.03)
Discontinued operations		0.08		0.10
	$ 0.08	$ 0.08	$ 0.17	$ 0.07
EARNINGS (LOSS) PER COMMON SHARE-DILUTED				
Continuing operations	$ 0.08	$	$ 0.17	$ (0.03)
Discontinued operations		0.08		0.10
	$ 0.08	$ 0.08	$ 0.17	$ 0.07

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NOTE 10. COMMITMENTS AND CONTINGENCIES

Legal

We are sometimes involved in various disputes, lawsuits, warranty claims, environmental and other matters arising in the ordinary course of business. Management makes assumptions and estimates concerning the likelihood and amount of any potential loss relating to these matters.

We are currently a party to various legal proceedings. We accrue a liability for litigation if an unfavorable outcome is probable and the amount of loss can be reasonably estimated. If an unfavorable outcome is probable and a reasonable estimate of the loss is a range, we accrue the best estimate within the range; however, if no amount within the range is a better estimate than any other amount, the minimum within the range is accrued. Legal fees related to litigation are expensed as incurred. We do not believe that the ultimate outcome of these matters, either individually or in the aggregate, could have a material adverse effect on our financial position or overall trends in results of operations; however, litigation is subject to inherent uncertainties. Also, under our leases, tenants are typically obligated to indemnify us from and against all liabilities, costs and expenses imposed upon or asserted against us as owner of the properties due to certain matters relating to the operation of the properties by the tenant.

Commitments

At The Landmark at One Market, we lease, as lessee, a building adjacent to The Landmark under an operating lease effective through June 30, 2016, which we have the option to extend until 2026 by way of two five-year extension options.

At Waikiki Beach Walk, we sublease a portion of the building of which Quiksilver is currently in possession, under an operating lease effective through December 31, 2021, which we have the option to extend at fair rental value in the event the sublessor extends its lease for the space with the master landlord. The lease payments under the lease will increase by approximately 3.4% annually through 2017 and, thereafter, will be equal to fair rental value, as defined in the lease, through lease expiration.

Current minimum annual payments under the leases are as follows, as of September 30, 2012 (in thousands):

Year Ending December 31,	
2012 (three months ending December 31, 2012)	$ 616
2013	2,502
2014	2,569
2015	2,636
2016	1,709
Thereafter	3,701 (1)
Total	$ 13,733

(1) Lease payments on the Waikiki Beach Walk lease will be equal to fair rental value from March 2017 through the end of the lease term. In the table, we have shown the lease payments for this period based on the stated rate for the month of February 2017 of $61,690.

We have management agreements with Outrigger Hotels & Resorts or an affiliate thereof (Outrigger) pursuant to which Outrigger manages each of the retail and hotel portions of the Waikiki Beach Walk property. Under the management agreement with Outrigger relating to the retail portion of Waikiki Beach Walk (the retail management agreement), we pay Outrigger a monthly management fee of 3.0% of net revenues from the retail portion of Waikiki Beach Walk. Pursuant to the terms of the retail management agreement, if the agreement is terminated in certain instances, including our election not to repair damage or destruction at the property, a condemnation or our failure to make required working capital infusions, we would be obligated to pay Outrigger a termination fee equal to the sum of the management fees paid for the two calendar months immediately preceding the termination date. The retail management agreement may not be terminated by us or by Outrigger without cause. Under our management agreement with Outrigger relating to the hotel portion of Waikiki Beach Walk (the hotel management agreement), we pay Outrigger a monthly management fee of 6.0% of the hotel s gross operating profit, as well as 3.0% of the hotel s gross revenues; provided that the aggregate management fee payable to Outrigger for any year shall not exceed 3.5% of the hotel s gross revenues for such fiscal year. Pursuant to the terms of the hotel management agreement, if the agreement is

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terminated in certain instances, including upon a transfer by us of the hotel or upon a default by us under the hotel management agreement, we would be required to pay a cancellation fee calculated by multiplying (1) the management fees for the previous 12 months by (2) (a) eight, if the agreement is terminated in the first 11 years of its term, or (b) four, three, two or one, if the agreement is terminated in the twelfth, thirteenth, fourteenth or fifteenth year, respectively, of its term. The hotel management agreement may not be terminated by us or by Outrigger without cause.

A wholly owned subsidiary of our Operating Partnership, WBW Hotel Lessee LLC, entered into a franchise license agreement with Embassy Suites Franchise LLC, the franchisor of the brand Embassy Suites , to obtain the non-exclusive right to operate the hotel under the Embassy Suites brand for 20 years. The franchise license agreement provides that WBW Hotel Lessee LLC must comply with certain management, operational, record keeping, accounting, reporting and marketing standards and procedures. In connection with this agreement, we are also subject to the terms of a product improvement plan pursuant to which we expect to undertake certain actions to ensure that our hotel s infrastructure is maintained in compliance with the franchisor s brand standards. In addition, we must pay to Embassy Suites Franchise LLC a monthly franchise royalty fee equal to 4.0% of the hotel s gross room revenue through December 2021 and 5.0% of the hotel s gross room revenue thereafter, as well as a monthly program fee equal to 4.0% of the hotel s gross room revenue. If the franchise license is terminated due to our failure to make required improvements or to otherwise comply with its terms, we may be liable to the franchisor for a termination payment, which could be as high as $5.6 million based on operating performance through September 30, 2012.

We have a property management agreement with Langley Investment Properties, Inc. (Langley) pursuant to which Langley manages and operates Lloyd District Portfolio, and we pay Langley a monthly management fee of 3.5% of gross receipts, as defined in the property management agreement, as well as leasing commissions and construction oversight fees in certain situations. The property management agreement has an initial term that expires on June 30, 2013, with three one-year renewal options, exercisable by us in our sole discretion. The property management agreement may not be terminated by us or by Langley without cause during the initial term, except by mutual consent of both parties.

Our Del Monte Center property has ongoing environmental remediation related to ground water contamination. The environmental issue existed at purchase and remediation is expected to conclude within the next two years. The work performed is financed through an escrow account funded by the seller upon purchase of the property. We believe the funds in the escrow account are sufficient for the remaining work to be performed. However, if further work is required costing more than the remaining escrow funds, we could be required to pay such overage, although we may have a contractual claim for such costs against the prior owner or our environmental remediation consultant.

In connection with the Formation Transactions, we entered into tax protection agreements with certain limited partners of our Operating Partnership. These agreements provide that if we dispose of any interest with respect to Carmel Country Plaza, Carmel Mountain Plaza, Del Monte Center, Loma Palisades, Lomas Santa Fe Plaza, Waikele Center or the ICW Plaza portion of Torrey Reserve Campus, in a taxable transaction during the period from the closing of the Offering through January 19, 2018, we will indemnify such limited partners for their tax liabilities attributable to their share of the built-in gain that existed with respect to such property interest as of the time of the Offering and tax liabilities incurred as a result of the reimbursement payment. Subject to certain exceptions and limitations, the indemnification rights will terminate for any such protected partner that sells, exchanges or otherwise disposes of more than 50% of his or her common units. We have no present intention to sell or otherwise dispose of the properties or interest therein in taxable transactions during the restriction period. If we were to trigger the tax protection provisions under these agreements, we would be required to pay damages in the amount of the taxes owed by these limited partners (plus additional damages in the amount of the taxes incurred as a result of such payment).

Concentrations of Credit Risk

Our properties are located in Southern California, Northern California, Hawaii, Oregon, Texas, and Washington. The ability of the tenants to honor the terms of their respective leases is dependent upon the economic, regulatory and social factors affecting the markets in which the tenants operate. Twelve of our consolidated properties are located in Southern California, which exposes us to greater economic risks than if we owned a more geographically diverse portfolio. Further, tenants in the retail industry accounted for 38.2% of total revenues for the nine months ended September 30, 2012. This makes us susceptible to demand for retail rental space and subject to the risks associated with an investment in real estate with a concentration of tenants in the retail industry. For the nine months ended September 30, 2012 and 2011, no tenant accounted for more than 10% of our total rental revenue.

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NOTE 11. OPERATING LEASES

Our leases with office, retail, mixed-use and residential tenants are classified as operating leases. Leases at our office and retail properties and the retail portion of our mixed-use property generally range from three to ten years (certain leases with anchor tenants may be longer), and in addition to minimum rents, usually provide for cost recoveries for the tenant s share of certain operating costs and also may include percentage rents based on the tenant s level of sales achieved. Leases on apartments generally range from 7 to 15 months, with a majority having 12 month lease terms. Rooms at the hotel portion of our mixed-use property are rented on a nightly basis.

As of September 30, 2012, minimum future rentals from noncancelable operating leases, before any reserve for uncollectible amounts and assuming no early lease terminations, at our office and retail properties and the retail portion of our mixed-use property are as follows for the years/period ending December 31 (in thousands):

Year Ending December 31,	
2012 (three months ending December 31, 2012)	$ 44,292
2013	151,623
2014	131,893
2015	118,281
2016	100,553
Thereafter	222,193
Total	$ 768,835

The above future minimum rentals exclude residential leases, which typically have a term of 12 months or less, and exclude the hotel, as rooms are rented on a nightly basis.

NOTE 12. COMPONENTS OF RENTAL INCOME AND EXPENSE

The principal components of rental income are as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Minimum rents				
Retail	$ 17,019	$ 15,847	$ 49,866	$ 48,062
Office	19,644	16,423	54,870	41,324
Multifamily	3,633	3,501	10,160	9,789
Mixed-use	2,114	2,239	6,649	6,275
Cost reimbursement	7,565	6,406	21,041	18,963
Percentage rent	533	455	1,259	1,090
Hotel revenue	9,017	8,010	24,142	20,274
Other	390	397	1,212	1,083

Total rental income	$ 59,915	$ 53,278	$ 169,199	$ 146,860