GREAT LAKES REIT
Form 10-Q
November 09, 2001

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, 2001

OR

/ /Transition Report Pursuant toSection 13 or 15(d)
of the Securities Exchange Act of 1934

Commission file number: 1-14307

Great Lakes REIT

(Exact name of Registrant as specified in its Charter)

Maryland	36-4238056
(State or other jurisdiction of incorporation or organization)	(IRS employer identification no.)

823 Commerce Drive, Suite 300, Oak Brook, IL 60523
(Address of principal executive offices) (Zip Code)

(630) 368 - 2900
(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 X No

Number of shares of the registrant's common shares of beneficial interest, $.01 par value per share, outstanding as of November 1, 2001: 16,547,079

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Great Lakes REIT
Consolidated Balance Sheets (unaudited)
(In thousands, except per share data)

	September 30, 2001
Assets	
Properties:	
Land	$65,014
Buildings, improvements, and equipment	456,477
	521,491
Less accumulated depreciation	53,583
	467,908
Cash and cash equivalents	2,575
Real estate tax escrows	286
Rents receivable	7,906
Deferred financing and leasing costs, net of accumulated amortization	6,916
Goodwill, net of accumulated amortization	1,079
Other assets	2,725
Total assets	$489,395
Liabilities and shareholders' equity	
Bank loan payable	$112,650
Mortgage loans payable	128,622

Bonds payable	3,960
Accounts payable and accrued liabilities	4,788
Accrued real estate taxes	13,615
Dividends payable	6,701
Prepaid rent	3,368
Security deposits	1,867
Total liabilities	275,571
Minority interests	671
Preferred shares of beneficial interest ($0.01 par value, 10,000 shares authorized; 1,500 9 3/4% Series A Cumulative Redeemable shares, with a $25.00 per share Liquidation Preference, issued and outstanding in 2001 and 2000)	37,500
Common shares of beneficial interest ($0.01 par value, 60,000 shares authorized; 18,301 and 18,275 shares issued in 2001 and 2000, respectively)	183
Paid-in-capital	235,307
Retained earnings (deficit)	(12,935)
Employee share loans	(20,206)
Deferred compensation	(2,399)
Treasury shares, at cost (1,583 shares in 2001, and 1,543 shares in 2000)	(24,297)
Total shareholders' equity	213,153
Total liabilities and shareholders' equity	$489,395

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

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Great Lakes REIT
Notes to Consolidated Financial Statements
(Unaudited)
Dollars in thousands, except per share data

1. Basis of Presentation

Great Lakes REIT, a Maryland real estate investment trust (the Company), was formed in 1992 to invest in income-producing real property. The principal business of the Company is the ownership, management, leasing, renovation and acquisition of suburban office properties, primarily located in the Midwest region of the United States. At September 30, 2001, the Company owned and operated 37 properties, primarily located in suburban areas of Chicago, Detroit, Milwaukee, Denver, Cincinnati, Columbus and Minneapolis. The Company leases office space to over 500 tenants that are engaged in a variety of businesses.

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries and controlled partnership. Intercompany accounts and transactions have been eliminated in consolidation.

The accompanying consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and do not include all information and footnotes necessary for a fair presentation of financial position, results of operations and cash flows in conformity with generally accepted accounting principles. These statements should be read in conjunction with the Company s most recent year-end audited financial statements, which are contained in the Company s Annual Report on Form 10-K for the year ended December 31, 2000, (the 2000 10-K). In the opinion of management, the financial statements contain all adjustments (which are normal and recurring) necessary for a fair statement of financial results for the interim periods. For further information, refer to the consolidated financial statements and notes thereto included in the 2000 10-K.

2. Derivatives and Hedging Activities

In June 1998, the Financial Accounting Standards Board issued Statement No. 133, Accounting for Derivatives and Hedging Activities, and its amendments, Statements No. 137 and 138, in June 1999 and June 2000, respectively. Statement No. 133, as amended, requires the Company to recognize all derivatives on its balance sheet at fair value effective January 1, 2001. Derivatives that are not hedges must be adjusted to fair

value through income. If the derivative is a hedge, depending on the nature of the hedge, changes in the fair value of the derivative are either offset against the change in fair value of the assets, liabilities or firm commitments through earnings or recognized in other comprehensive income until the hedged item is recognized in earnings. The ineffective portion of a derivative s change in fair value will be immediately recognized in earnings.

In 1999, the Company purchased an interest rate cap agreement that expired in June 2001 to hedge its exposure to increases in interest costs under its variable rate debt. During the nine months ended September 30, 2001, the Company recorded $78 of interest expense, which reduced the carrying value of the cap to -0-.

In October 2001, the Company entered into two separate interest rate swap agreements with notional amounts of $25,000 each. One agreement has a term of two years and fixes the interest rate on $25,000 of the Company s unsecured credit facility at a maximum of 4.12%. The second swap agreement has a term of three years and fixes the interest rate on $25,000 of the Company s unsecured credit facility at a maximum of 4.51% per annum.

3. Segment Information

The Company has two reportable segments, distinguished by property type. The property types are office and office service center which represent 89% and 11% (as measured by square feet) of the Company s overall portfolio, respectively. Office buildings are generally single-story or multi-story buildings used by tenants for office activities. The buildings generally have common area lobbies and other amenities, including food service areas, atriums and limited underground parking facilities. Office service center buildings generally are one-story buildings with no common areas. Tenant spaces generally have less than 100% office use with the non-office space used for showroom, technical or light storage purposes. As of September 30, 2001, the properties were leased to more than 500 tenants, no single tenant accounted for more than 5% of the aggregate annualized base rent of the Company s portfolio and only 20 tenants individually represented more than 1% of the aggregate annualized base rent.

The Company evaluates performance and makes investment decisions in part based on net operating income, which is property revenues (rental and reimbursement income) less property operating expenses and real estate taxes. Net operating income is a widely-recognized industry measure of a property s performance.

The following table represents a summary report of segment information for the three and nine months ended September 30, 2001 and 2000:

	Three months ended Nine months ended September 30, September 30,		
	2001	2000	2001
Revenues			
Office	$23,938	$22,783	$70,300
Office service center	1,293	1,648	4,116
Deferred rental revenues	-	222	-
Interest and other	891	751	2,644
Total	$26,122	$25,404	$77,060
Net operating income			
Office	$13,404	$13,235	$40,454
Office service center	828	1,171	2,573
Total	$14,232	$14,406	$43,027
Depreciation and amortization			
Office	$4,382	$3,850	$12,653
Office service center	308	298	916
Other	145	138	428
Total	$4,835	$4,286	$13,997
Interest expense			

Office	$3,462	$3,499	$10,072
Office service center	214	391	641
Total	$3,676	$3,890	$10,713

4. Long-Term Debt

The Company is a party to a $150,000 unsecured credit facility that matures on March 23, 2004. The interest rate on borrowings under the credit facility is LIBOR plus 1.0% to 1.2% depending on overall Company leverage. The credit facility contains financial covenants, including requirements for a minimum tangible net worth, maximum liabilities to asset values, debt service requirements, maximum liabilities to asset values, debt service coverage and net property operating income. The credit facility also contains restrictions on, among other things, indebtedness, investments, dividends, liens, mergers and development activities.

On June 1, 2001 the Company entered into a $33,046 loan agreement with an institutional lender. The loan is secured by a first mortgage lien on its Milwaukee Center property, located in Milwaukee, Wisconsin, and bears interest at a fixed annual interest rate of 7.435% with a ten-year term. The net proceeds from the loan (approximately $33 million) were used to repay a portion of the Company s unsecured credit facility.

5. Property Acquisitions

On March 1, 2001, the Company acquired 1600 Corporate Center, a 252,000 square foot multi-story office building located in Rolling Meadows, Illinois, for a contract price of $26,000.

On August 10, 2001, the Company acquired Bannockburn Corporate Center, a 202,000 square foot multi-story office building located in Bannockburn, Illinois, for a contract price of $31,800.

6. Restricted Share Grants

On June 1, 2000, the Company issued 200,000 restricted common shares to certain officers and employees. The shares vest ten years from the date of issuance provided the recipient is still employed by the Company, but may vest earlier in increments during the period ending December 31, 2002 if the Company achieves certain performance objectives. Upon a change in control of the Company, up to 100,000 of the restricted shares issued to certain officers of the Company vest immediately. The total fair value of the restricted shares at the date of issuance ($3,138) is being amortized into expense over ten years on a straight-line basis, subject to adjustment when the Company determines that it is probable to achieve certain performance objectives which accelerate the full or partial vesting of the shares. The Company recorded compensation expense of $72 and $216 for the three and nine months ended September 30, 2001, respectively.

7. Earnings per Share

The unvested restricted common share grants (166,664 shares at September 30, 2001) are excluded from the common shares used to compute basic earnings per share. The unvested restricted common shares are included in the shares used to compute fully diluted earnings per share using the treasury stock method whereby the unamortized deferred compensation related to these shares is assumed to be the exercise value of these shares.

The Company has 40,199 operating partnership units held by non-affiliates of the Company outstanding at September 30, 2001, which are convertible to common shares on a one for one basis at the option of the holder.

8. Goodwill

In June 2001, the Financial Accounting Standards Board issued Statements of Financial Accounting Standards No. 141, Business Combinations, and No. 142, Goodwill and Other Intangible Assets, effective for fiscal years beginning after December 15, 2001. Under the new rules, goodwill will no longer be amortized but will be subject to annual impairment tests in accordance with these Statements.

The Company will apply the new rules on accounting for goodwill and other intangible assets beginning in the first quarter of 2002. Application of the non-amortization provisions of these Statements is expected to result in an increase in net income of $75 per year. During 2002, the Company will perform the first of the required impairment tests of goodwill as of January 1, 2002, and has not yet determined what the effect of

these tests will be on the earnings and financial position of the Company.

9. Impairment of Assets

In August 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 144, Accounting for Impairment or Disposal of Long-lived Assets, which is effective for fiscal years beginning after December 15, 2001. Application of the provisions of this statement is not expected to affect the earnings and financial position of the Company.

10. Commitments and Contingencies

In 2000, the Company entered into a contract to acquire a 99,500 square foot office building currently under construction in suburban Milwaukee for a contract price of $8,500. The Company s total investment in this property, including tenant improvements, is expected to be $11,700. The Company has guaranteed a letter of credit in the amount of $2,000 to secure its obligations related to this property.

ITEM 2. Management's Discussion and Analysis of Results of Operations and Financial Condition (Dollars in thousands)

The following is a discussion and analysis of the consolidated financial condition and results of operations for the three and nine months ended September 30, 2001. The following should be read in conjunction with the consolidated financial statements and related notes appearing elsewhere herein and the consolidated financial statements and related notes contained in the 2000 10-K.

Overview

The principal business of the Company is the ownership, management, leasing, renovation, and acquisition of suburban office properties located primarily in the Midwest region of the United States. At September 30, 2001, the Company owned and operated 37 properties, primarily located in suburban areas of Chicago, Detroit, Milwaukee, Columbus, Minneapolis, Denver and Cincinnati. The Company leases space to over 500 tenants that are engaged in a variety of businesses.

Three months ended September 30, 2001 compared to three months ended September 30, 2000.

In analyzing the operating results for the three months ended September 30, 2001, the changes in rental and reimbursement income, real estate taxes and other property operating expenses from 2000 are due principally to: (i) the addition of a full year s operating results in 2001 of properties acquired in 2000 compared to the partial year s operating results from the dates of their respective acquisitions in 2000, (ii) the addition of operating results of properties acquired in 2001 from the dates of acquisition, (iii) the effect of property dispositions in 2000 and (iv) changes in operations of properties during 2001 compared to 2000. Other property operating expenses include contract services, repairs, maintenance, utilities, personnel, insurance and other costs directly associated with the leasing, management and operation of the properties.

	Rental income	Reimbursement income	Real es taxes
Increase due to properties acquired in 2000	$ 111	$122	$240
Increase due to properties acquired in 2001	1,121	710	344
Effect of property dispositions in 2000	(430)	(366)	(153)
Increase (decrease) in 2001 as compared to 2000	106	(613)	442
Total	$908	($147)	$873

Telecommunications income increased by $41 during the quarter ended September 30, 2001 as compared to 2000 as the Company signed additional agreements subsequent to September 30, 2001.

Tenant service income decreased by $56 in the quarter ended September 30, 2001 as compared to 2000 as tenants use of additional services declined.

Interest income decreased by $59 during the quarter ended September 30, 2001, as compared to 2000 as the Company had a higher average cash balance in 2000 as compared to 2001.

General and administrative expenses decreased by $144 during the quarter ended September 30, 2001 as compared to 2000 due to decreased bonus compensation costs and decreased compensation expenses associated with the restricted share plan.

Interest expense declined by $214 during the quarter ended September 30, 2001 as compared to 2000 due to lower interest rates on amounts outstanding under its unsecured credit facility in 2001.

Depreciation and amortization expenses increased by $549 during the quarter ended September 30, 2001 as compared to 2000 because the Company had a gross book value of depreciable assets of $456,477 at September 30, 2001 as compared to $416,672 at September 30, 2000.

Nine months ended September 30, 2001 compared to nine months ended September 30, 2001

In analyzing the operating results for the nine months ended September 30, 2001, the changes in rental and reimbursement income, real estate taxes and other property operating expenses from 2000 are due principally to: (i) the addition of a full year s operating results in 2001 of properties acquired in 2000 compared to the partial year s operating results from the dates of their respective acquisitions in 2000, (ii) the addition of operating results of properties acquired in 2001 from the dates of acquisition, (iii) the effect of property dispositions in 2000 and (iv) changes in operations of properties during 2001 compared to 2000. Other property operating expenses include contract services, repairs, maintenance, utilities, personnel, insurance and other costs directly associated with the leasing, management and operation of the properties.

	Rental income	Reimbursement income	Real estate taxes	Pro ope exp
Increase due to properties acquired in 2000	$ 731	$647	$466	
Increase due to property acquired in 2001	2,067	1,448	716	
Effect of property dispositions in 2000	(1,681)	(1,029)	(396)	
Increase (decrease) in 2001 as compared to 2000	1,466	(1,555)	819	
Total	$2,583	($489)	$1,605	

Telecommunications income increased by $84 during the nine months ended September 30, 2001 as compared to 2000 due to agreements signed in 2000 having nine months of revenue in 2001 compared to less than nine months of revenue in 2000.

Tenant service income increased by $133 in the nine months ended September 30, 2001 as the Company earned nine months of income in 2001 as compared to a partial period in 2000 since the Company commenced its efforts to increase this income in mid-2000.

Interest income decreased by $109 during the nine months ended September 30, 2001 as compared to 2000 as the Company had a higher average cash balance in 2000 as compared to 2001.

Interest expense declined by $732 during the nine months ended September 30, 2001 as compared to 2000 due to lower interest rates on its unsecured credit facility in 2001.

Depreciation and amortization expenses increased by $1,412 during the nine months ended September 30, 2001 as compared to 2000 because the Company had a gross book value of depreciable assets of $456,477 at September 30, 2001 as compared to $416,672 at September 30, 2000.

Segment Operations

The Company has two reportable segments, distinguished by property type. The property types are office and office service center. Office buildings are generally single-story or multi-story buildings used by tenants for office activities. The buildings generally have common area lobbies and other amenities including food service areas, atriums and limited underground parking facilities. Office service center buildings generally are one-story buildings with no common areas. Tenant spaces generally have less than 100% office use with the non-office space used for showroom, technical or light storage purposes.

The net income for the office segment is as follows:

	Three months ended September 30		Nine months ended
	2001	2000	2001
Net operating income	$13,404	$13,235	$40,454
Interest expense	(3,462)	(3,499)	(10,072)
Depreciation	(4,382)	(3,850)	(12,653)
Segment net income	$ 5,560	$ 5,886	$17,729

The decrease in the office segment net income for the three months and nine months ended September 30, 2001 as compared to 2000 was due to increased depreciation expense in 2001 as the Company had a higher gross book value of depreciable office assets in 2001 as compared to 2000.

The net income for the office service center segment is as follows:

	Three months ended September 30		Nine months ended
	2001	2000	2001
Net operating income	$ 828	$ 1,171	$2,573
Interest expense	(214)	(391)	(641)
Depreciation	(308)	(298)	(916)
Segment net income	$ 306	$ 482	$1,016

The decrease in segment net income for the three months and nine months ended September 30, 2001 as compared to 2000 was due to the sale of the Company s Woodcreek office service center property in 2000 as well as decreases caused by declining occupancies in this property segment.

Liquidity and Capital Resources

The Company expects to meet its short-term liquidity requirements principally through its working capital and net cash provided by operating activities. The Company considers its cash provided by operating activities to be adequate to meet operating requirements and to fund the payment of dividends in order to comply with certain federal income tax requirements applicable to real estate investment trusts (REITs).

The Company is a party to a $150,000 unsecured credit matures on March 23, 2004. Borrowings under the credit facility bear interest at LIBOR plus 1.0% to 1.2%, depending on overall Company leverage. The credit facility contains financial covenants, including requirements for a minimum tangible net worth, maximum liabilities to asset values, debt service coverage and net property operating income. The credit facility also contains restrictions on, among other things, indebtedness, investments, dividends, liens, mergers and development activities.

On June 1, 2001, the Company entered into a $33,046 loan agreement with an institutional lender. The loan is secured by a first mortgage lien on its Milwaukee Center property, located in Milwaukee, Wisconsin, and bears interest at a fixed annual interest rate of 7.435% with a ten-year term. The net proceeds from the loan (approximately $33 million) were used to repay a portion of the outstanding borrowings under the Company s unsecured credit facility.

In October 2001, the Company entered into two separate interest rate swap agreements with notional amounts of $25,000 each. One agreement has a term of two years and fixes the interest rate on $25,000 of the Company s unsecured credit facility at a maximum of 4.12%. The second swap agreement has a term of three years and fixes the interest rate on $25,000 of the Company s unsecured credit facility at a maximum of 4.51% per annum.

In 2001, the Company repurchased 223,400 common shares for $3,650 which completed the 250,000 common share repurchase plan authorized by the Board of Trustees in 2000.

The Company expects to meet its liquidity requirements for property acquisitions and significant capital improvements through property dispositions and additional borrowings under its unsecured credit facility. The Company had $37,350 available for future borrowings under the

credit facility at September 30, 2001.

The Company expects to meet its long-term liquidity requirements (such as scheduled mortgage debt maturities, property acquisitions and significant capital improvements) through long-term collateralized and uncollateralized borrowings, the issuance of debt or equity securities and targeted property dispositions.

The Company entered into a contract in 2000 to acquire a 99,500 square foot office building, which was completed in June 2001, in suburban Milwaukee, Wisconsin, for a contract price of $8,500. The Company s total investment in this property, including tenant improvements, is expected to be $11,700. The Company expects to acquire this property in early 2002. The Company has guaranteed a letter of credit in the amount of $2,000 to secure its obligations related to this property.

Forward-Looking Statements

Statements regarding the Company s liquidity requirements and certain other statements in this report are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. The words believe, expect, anticipate and similar expressions identify forward-looking statements. Although the Company believes that the expectations reflected in these forward-looking statements are based on reasonable assumptions, there can be no assurance that such expectations will be met. Various factors could cause actual results to differ materially from the Company s expectations, including changes in interest rates, unexpected delays in project lease-up, changes in the local or national economies, unanticipated changes in the supply or demand for office space, increased sub-lease availability which could negatively impact space absorption, and other risks inherent in the real estate business. Many of these factors are beyond the Company s ability to control or predict. Forward-looking statements are not guarantees of performance. For forward-looking statements made in this report, the Company claims the protection of the safe harbor for forward-looking statements made in the Private Securities Litigation Reform Act of 1995. The Company assumes no obligation to update or supplement forward-looking statements.

ITEM 3. MARKET RISK (Dollars in thousands)

The Company's interest income is sensitive to changes in the general levels of U.S. short-term interest rates.

The Company s interest expense is sensitive to changes in the general level of U.S. short-term and long-term interest rates as the Company has indebtedness outstanding at fixed and variable rates.

The Company s variable rate debt bears interest at LIBOR plus 1% to 1.2% per annum depending on overall Company leverage. Increases in LIBOR rates would increase the Company s interest expense and reduce its cash flow. Conversely, declines in LIBOR rates would decrease its interest expense and increase its cash flow.

At September 30, 2001, the Company had $128,622 of fixed rate debt outstanding at an average rate of 7.07%. If the general level of interest rates in the United States were to fall, the Company would not likely have the opportunity to refinance this fixed rate debt at lower interest rates due to prepayment restrictions and penalties on its fixed rate debt.

In general, the Company believes long-term fixed rate debt is preferable as a financing vehicle for its operations due to the long-term fixed contractual rental income the Company receives from its tenants. As a result, 52.5% of the Company s long-term debt outstanding at September 30, 2001 was at fixed rates. The Company may, as market conditions warrant, enter into additional fixed rate long-term debt instruments on either a secured or unsecured basis.

A tabular presentation of interest rate sensitivity is as follows:

Interest Rate Sensitivity
Principal Amount by Expected Maturity
Average Interest Rate

	2001(1)	2002	2003	2004	2005
Liabilities:					
Fixed Rate					
Mortgage loans payable	$758	$3,174	$14,208	$5,814	$3,450
Average interest rate	7.02%	7.02%	7.07%	7.83%	6.93%
Variable Rate (4)					
Bank loan payable	-	-	-	$112,650	-
Average interest rate (2)					
Bonds payable	-	$340	$375	$415	$460
Average interest rate	(3)	(3)	(3)	(3)	(3)

(1) For the period October 1, 2001 to December 31, 2001.

(2) As of September 30, 2001, the interest rate on this debt was LIBOR + 1.1%. The average interest rate for the nine months ended September 30, 2001 was 6.06%.

(3) The interest rate on the bonds payable is reset weekly. After factoring in credit enhancement costs for the bonds, the average interest rate for the nine months ended September 30, 2001 was 5.65%.

(4) In October 2001, the Company entered into two separate interest rate swap agreements with notional amounts of $25,000 each. One agreement has a term of two years and fixes the interest rate on $25,000 of the Company s unsecured credit facility at a maximum of 4.12%. The second swap agreement has a term of three years and fixes the interest rate on $25,000 of the Company s unsecured credit facility at a maximum of 4.51% per annum.

Part II Other Information

ITEM 6. Exhibits and Reports on Form 8-K

(a) Exhibits
The following exhibits are attached hereto:

Exhibit Number		Description of Document
(b)	Reports on Form 8-K:	
	Item 2 and Item 7.	Form 8-K dated August 24, 2001 Acquisition of Bannockburn Corporate Center
	Item 2 and Item 7.	Form 8-K/A dated October 23, 2001 Acquisition of Bannockburn Corporater Center and 1600 Corporate Center and required financial statements.

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 thereunto duly authorized.

Great Lakes REIT.
(Registrant)

Date: November 9, 2001

/s/James Hicks
Chief Financial Officer and Treasurer
(Principal Financial and Accounting Officer)