Hudson Pacific Properties, Inc.
Form 10-Q
November 15, 2010
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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, 2010

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

For the Transition Period from______ to ______

Commission File Number 001-34789

Hudson Pacific Properties, Inc.

(Exact name of Registrant as specified in its charter)

Maryland	**27-1430478**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification Number)**
11601 Wilshire Blvd., Suite 1600 Los Angeles, California	**90025**
(Address of principal executive offices)	**(Zip Code)**

(310) 445-5700

(Registrant s telephone number, including area code)

(Former name, former address and former fiscal year if changed since last report)

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

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

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

Large accelerated filer	¨	Accelerated filer	¨
Non-accelerated filer	x	Smaller reporting company	¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x.

The number of shares of Class A common stock outstanding at November 15, 2010 was 22,217,096.

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Hudson Pacific Properties, Inc.

FORM 10-Q

September 30, 2010

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HUDSON PACIFIC PROPERTIES, INC.

CONSOLIDATED BALANCE SHEETS

(Unaudited)

(in thousands, except share data)

	September 30, 2010	December 31, 2009
ASSETS		
REAL ESTATE ASSETS		
Land	$ 204,213	193,042
Building and improvements	296,713	206,715
Tenant improvements	21,118	14,344
Furniture and fixtures	11,919	11,097
Property under development	6,071	4,148
Total real estate held for investment	540,034	429,346
Accumulated depreciation and amortization	(24,222)	(16,868)
Investment in real estate, net	515,812	412,478
Cash and cash equivalents	40,741	3,694
Restricted cash	2,217	4,231
Accounts receivable, net of allowance of $216 and $308	3,346	1,273
Straight-line rent receivables	5,745	2,935
Deferred leasing costs and lease intangibles, net	39,317	18,727
Deferred finance costs, net	3,532	668
Goodwill	8,754	
Prepaid expenses and other assets	4,451	4,228
TOTAL ASSETS	$ 623,915	448,234
LIABILITIES AND EQUITY		
Notes payable	$ 94,069	$ 189,518
Accounts payable and accrued liabilities	10,746	6,026
Below-market leases	12,014	11,636
Security deposits	4,275	2,939
Prepaid rent	8,839	11,102
Interest rate contracts	112	425
TOTAL LIABILITIES	130,055	221,646
6.25% Series A Cumulative Redeemable Preferred units of the Operating Partnership	12,670	
EQUITY		
Members equity		223,240
Hudson Pacific Properties, Inc. stockholders equity:		
Common stock, $0.01 par value 490,000,000 authorized, 22,211,799 outstanding at September 30, 2010	222	
Additional paid-in capital	416,624	
Accumulated other comprehensive loss	(30)	
Accumulated deficit	(1,948)	

Total Hudson Pacific Properties, Inc. stockholders equity		414,868	223,240
Non-controlling interests:			
Members in consolidated real estate entities			3,348
Unitholders in the Operating Partnership		66,322	
		66,322	3,348
TOTAL EQUITY		481,190	226,588
TOTAL LIABILITIES AND EQUITY	$	623,915	448,234

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

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HUDSON PACIFIC PROPERTIES, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(in thousands, except share and per share amounts)

	Three Months Ended September 30, 2010	Three Months Ended September 30, 2009	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
Revenues				
Office				
Rental	$ 6,521	$ 2,900	$ 12,786	8,349
Tenant recoveries	1,001	423	1,915	1,435
Other	97	131	125	152
Total office revenues	7,619	3,454	14,826	9,936
Media & Entertainment				
Rental	5,246	4,915	15,453	15,300
Tenant recoveries	363	348	1,179	1,225
Other property-related revenue	4,194	2,824	7,996	7,402
Other	83	15	96	57
Total media & entertainment revenues	9,886	8,102	24,724	23,984
Total revenues	17,505	11,556	39,550	33,920
Operating Expenses				
Office operating expenses	2,822	1,540	5,650	4,328
Media & entertainment operating expenses	5,959	5,093	15,194	14,451
General and administrative	2,379		2,379	
Depreciation and amortization	4,317	2,729	9,985	8,334
Total operating expenses	15,477	9,362	33,208	27,113
Income from operations	2,028	2,194	6,342	6,807
Other Expense (Income)				
Interest expense	1,784	2,231	6,196	6,702
Interest income	(31)	(4)	(37)	(9)
Unrealized (gain) of interest rate contracts		(104)	(347)	(208)
Acquisition-related expenses	256		2,689	
Other expense	(8)	(26)	(8)	97
	2,001	2,097	8,493	6,582
Net income (loss)	27	97	(2,151)	225

Less: Net income attributable to preferred non-controlling partnership interest	(195)		(199)	
Less: Net income attributable to restricted shares	(25)		(25)	
Add: Net loss (income) attributable to non-controlling members in consolidated real estate entities		(2)	32	(4)
Add: Net loss attributable to Unitholders in the Operating Partnership	21		277	
(Loss) income attributable to Hudson Pacific Properties, Inc. shareholders / controlling member s equity	$ (172)	$ 95	$ (2,066)	$ 221
Net (loss) attributable to shareholders per share - basic and diluted	$ (0.01)			
Weighted average shares of common stock outstanding - basic and diluted	21,946,508			
Dividends declared per common share	$ 0.0971		$ 0.0971	

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HUDSON PACIFIC PROPERTIES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(in thousands)

	Nine Months Ended September 30, 2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	$ (2,151)	$ 225
Adjustments to reconcile net income (loss) to net cash (used in) provided by operating activities:		
Depreciation and amortization	9,985	8,334
Amortization of deferred financing costs	1,013	1,193
Amortization of stock based compensation	375	
Straight-line rent receivables	(2,810)	(1,038)
Amortization of above-market leases	597	546
Amortization of below-market leases	(788)	(876)
Bad debt expense		70
Amortization of ground lease	15	
Unrealized gain on interest rate contract	(347)	(208)
Loss on sale of asset		33
Change in operating assets and liabilities:		
Restricted cash	2,014	(1,530)
Accounts receivable	(1,853)	(499)
Lease intangibles	(1,363)	(47)
Prepaid expenses and other assets	(285)	(1,811)
Accounts payable and accrued liabilities	857	(349)
Security deposits	753	702
Prepaid rent	(2,591)	(2,495)
Net cash provided by operating activities	3,421	2,250
CASH FLOWS FROM INVESTING ACTIVITIES		
Additions to investment property	(7,479)	(10,142)
Purchase of properties	(49,188)	
Proceeds from sale of equipment		30
Net cash used in investing activities	(56,667)	(10,112)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from notes payable	5,268	1,437
Payments of notes payable	(157,786)	
Proceeds from issuance of common stock, net of certain transaction costs, of $(7,169)	225,551	
Proceeds from private placement of common stock	20,000	
Acquisition of non-controlling members interest	(828)	
Contributions by members	3,653	5,693
Distribution to members	(1,703)	(900)
Payment of loan costs	(3,862)	(476)

Net cash provided by financing activities	90,293	5,754
Net increase (decrease) in cash and cash equivalents	37,047	(2,108)
Cash and cash equivalents-beginning of period	3,694	5,813
Cash and cash equivalents-end of period	$ 40,741	$ 3,705
Supplemental disclosure of cash flow information		
Cash paid for interest, net of amounts capitalized	$ 5,482	$ 6,157

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

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Notes to Consolidated Financial Statements

(Unaudited and in thousands, except square footage and share data)

1. Organization and Basis of Presentation

Hudson Pacific Properties, Inc. (which is referred to in these financial statements as the Company, we, us, or our) is a Maryland corporation formed on November 9, 2009 that did not have any meaningful operating activity until the consummation of our initial public offering and the related acquisition of our predecessor and certain other entities in June 2010.

We combined with our predecessor and Howard Street Associates LLC and acquired certain other entities simultaneously with the closing of our initial public offering on June 29, 2010 (IPO). On June 29, 2010, we completed the following transactions (which are also more fully discussed in footnote 9, below):

In our IPO we issued a total of 14,720,000 shares of our common stock in exchange for gross proceeds of approximately $250.2 million in cash.

In a concurrent private placement, we issued a total of 1,176,471 shares of our common stock in exchange for gross proceeds of $20.0 million in cash.

In our formation transactions, we acquired certain assets of our predecessor and other entities in exchange for the assumption or discharge of $246.3 million in indebtedness, the payment of $7.2 million in cash, and the issuance of 2,610,941 common units of partnership interest in our operating partnership, 499,014 series A preferred units of partnership interest in our operating partnership and 6,050,037 million shares of our common stock.

We entered into a $200.0 million senior secured revolving credit facility, with an accordion feature to increase the availability to $250.0 million under specified circumstances.

Because these transactions did not occur until shortly before June 30, 2010, the financial condition and results of operations for the entities acquired by our predecessor in connection with the IPO and related formation transactions are only included in certain historical financial statements. More specifically, our financial condition as of December 31, 2009 and results of operations for the nine-month period ending September 30, 2009 reflect the financial condition and operating results for the combined predecessor entities consisting of HFOP City Plaza, LLC (asset owning entity of City Plaza), Sunset Bronson Entertainment Properties, LLC (asset owning entity of Sunset Bronson media and entertainment property), SGS Realty II, LLC (asset owning entity of Sunset Gower media and entertainment property and the Technicolor building), in addition to Howard Street Associates LLC (the asset-owning entity of 875 Howard Street). Our financial condition as of September 30, 2010 and results of operations for the three- and nine-month periods ending September 30, 2010 reflect the financial condition of the aforementioned predecessor entities, together with the entities we acquired at the time of our IPO, namely, Glenborough Tierrasanta, LLC (asset-owning entity of Tierrasanta), GLB Encino, LLC (asset-owning entity of First Financial) and Hudson Capital, LLC, in each case from the date of their acquisition. Our financial condition as of September 30, 2010 and results of operations for the three- and nine-month periods ending September 30, 2010 also reflect the acquisitions the Del Amo Office property and 9300 Wilshire Boulevard office property, from the date of each such acquisition.

We have determined that one of the entities comprising our predecessor, SGS Realty II, LLC, is the acquirer for accounting purposes. In addition, we have concluded that any interests contributed by the controlling member of the other entities comprising our predecessor and Howard Street Associates, LLC is a transaction between entities under common control. As a result, the contribution of interests in each of these entities has been recorded at historical cost and our historical financial statements have been amended to reflect the results of our predecessor and Howard Street Associates, LLC. The consideration we paid in connection with the contribution of the ownership of these entities to us is described in the third bullet point appearing above.

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Notes to Consolidated Financial Statements (Continued)

(Unaudited and in thousands, except square footage and share data)

After the completion of the IPO, the concurrent private placement, and the related formation transactions that occurred on June 29, 2010, we are a fully integrated, self-administered, and self-managed real estate investment trust (REIT). Through our controlling interest in Hudson Pacific Properties, L.P. (our Operating Partnership) and its subsidiaries, we own, manage, lease, acquire and develop real estate, consisting primarily of office and media and entertainment properties. As of September 30, 2010, we owned a portfolio of seven office properties and two media and entertainment properties. All of these properties are located in California. We expect to qualify as a REIT for federal income tax purposes beginning with our initial taxable year ending December 31, 2010.

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 results of operations for the three and nine months ended September 30, 2010 are not necessarily indicative of the results of operations to be expected for the year ending December 31, 2010. The consolidated financial statements and notes to consolidated financial statements should be read in conjunction with our June 23, 2010 Prospectus, which contains the latest available audited combined financial statements of our predecessor and notes thereto, which are as of and for the year ended December 31, 2009. Any reference to the number of properties and square footage are unaudited and outside the scope of our independent registered public accounting firm s review of our financial statements in accordance with the standards of the United States Public Company Accounting Oversight Board.

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying consolidated/combined financial statements of the Company are prepared in accordance with GAAP. The effect of all significant intercompany balances and transactions has been eliminated. The real estate entities included in the accompanying combined financial statements have been combined on the basis that, for the periods prior to the completion of the offering, such entities were under common control.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of commitments and contingencies at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could materially differ from these estimates.

Investment in Real Estate Properties

The properties are carried at cost less accumulated depreciation and amortization. The Company allocates the cost of an acquisition, including the assumption of liabilities, to the acquired tangible assets and identifiable intangibles based on their estimated fair values in accordance with GAAP. The Company assesses fair value based on estimated cash flow projections that utilize appropriate discount and/or capitalization rates and available market information. Estimates of future cash flows are based on a number of factors including historical operating results, known and anticipated trends, and market and economic conditions. The fair value of tangible assets of an acquired property considers the value of the property as if it was vacant. Acquisition-related expenses are expensed in the period incurred.

Notes to Consolidated Financial Statements (Continued)

(Unaudited and in thousands, except square footage and share data)

Impairment of Long-Lived Assets

The Company assesses the carrying value of real estate assets and related intangibles, whenever events or changes in circumstances indicate that the carrying amount of an asset or asset group may not be recoverable in accordance with GAAP. Impairment losses are recorded on real estate assets held for investment when indicators of impairment are present and the future undiscounted cash flows estimated to be generated by those assets are less than the assets carrying amount. The Company recognizes impairment losses to the extent the carrying amount exceeds the fair value of the properties. Properties held for sale are recorded at the lower of cost or estimated fair value less cost to sell. The Company did not record any impairment charges related to its real estate assets and related intangibles during the three and nine months ended September 30, 2010 and 2009.

Cash and Cash Equivalents

Cash and cash equivalents are defined as cash on hand and in banks plus all short term investments with a maturity of three months or less when purchased.

The Company maintains some of its cash in bank deposit accounts that, at times, may exceed the federally insured limit. No losses have been experienced related to such accounts.

Restricted Cash

Restricted cash consists of amounts held by lenders to provide for future real estate taxes and insurance expenditures, repairs and capital improvements reserves, general and other reserves and security deposits.

Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable consist of amounts due for monthly rents and other charges. The Company maintains an allowance for doubtful accounts, including an allowance for straight-line rent receivables, for estimated losses resulting from tenant defaults or the inability of tenants to make contractual rent and tenant recovery payments. The Company monitors the liquidity and creditworthiness of its tenants and operators on an ongoing basis. This evaluation considers industry and economic conditions, property performance, credit enhancements and other factors. For straight-line rent amounts, the Company s assessment is based on amounts estimated to be recoverable over the term of the lease. At September 30, 2010 and December 31, 2009, management believes that the collectability of straight-line rent balances are reasonably assured; accordingly, no allowance was established against straight-line rent receivables. The Company evaluates the collectability of accounts receivable based on a combination of factors. The allowance for doubtful accounts is based on specific identification of uncollectible accounts and the Company s historical collection experience. The Company recognizes an allowance for doubtful accounts based on the length of time the receivables are past due, the current business environment and the Company s historical experience. Historical experience has been within management s expectations.

Revenue Recognition

The Company recognizes rental revenue from tenants on a straight-line basis over the lease term when collectability is reasonably assured and the tenant has taken possession or controls the physical use of the leased asset. For assets acquired subject to leases, the Company recognizes revenue upon acquisition of the asset, provided the tenant has taken possession or controls the physical use of the leased asset. If the lease provides for tenant improvements, the Company determines whether the tenant improvements, for accounting purposes, are owned by the tenant or the Company. When the Company is the owner of the tenant improvements, the tenant is not considered to have taken physical possession or have control of the physical use of the leased asset until the tenant improvements are substantially completed. When the tenant is the owner of the tenant improvements, any tenant improvement allowance that is funded is treated as a lease incentive and amortized as a reduction of revenue over the lease term. Tenant improvement ownership is determined based on various factors including, but not limited to:

whether the lease stipulates how and on what a tenant improvement allowance may be spent;

Notes to Consolidated Financial Statements (Continued)

(Unaudited and in thousands, except square footage and share data)

whether the tenant or landlord retains legal title to the improvements at the end of the lease term;

whether the tenant improvements are unique to the tenant or general-purpose in nature; and

whether the tenant improvements are expected to have any residual value at the end of the lease.

Certain leases provide for additional rents contingent upon a percentage of the tenant s revenue in excess of specified base amounts or other thresholds. Such revenue is recognized when actual results reported by the tenant, or estimates of tenant results, exceed the base amount or other thresholds. Such revenue is recognized only after the contingency has been removed (when the related thresholds are achieved), which may result in the recognition of rental revenue in periods subsequent to when such payments are received.

Other property related revenue is revenue that is derived from the tenants use of lighting, equipment rental, parking, power, HVAC and telecommunications (phone and internet). Other property related revenue is recognized when these items are provided.

Tenant recoveries related to reimbursement of real estate taxes, insurance, repairs and maintenance, and other operating expenses are recognized as revenue in the period the applicable expenses are incurred. The reimbursements are recognized and presented gross, as the Company is generally the primary obligor with respect to purchasing goods and services from third-party suppliers, has discretion in selecting the supplier and bears the associated credit risk.

The Company recognizes gains on sales of properties upon the closing of the transaction with the purchaser. Gains on properties sold are recognized using the full accrual method when (i) the collectability of the sales price is reasonably assured, (ii) the Company is not obligated to perform significant activities after the sale, (iii) the initial investment from the buyer is sufficient and (iv) other profit recognition criteria have been satisfied. Gains on sales of properties may be deferred in whole or in part until the requirements for gain recognition have been met.

Deferred Financing Costs

Deferred financing costs are amortized over the term of the respective loan.

Derivative Financial Instruments

The Company manages interest rate risk associated with borrowings by entering into interest rate derivative contracts. The Company recognizes all derivatives on the balance sheet at fair value. Derivatives that are not hedges are adjusted to fair value and the changes in fair value are reflected as income or expense. If the derivative is a hedge, depending on the nature of the hedge, changes in the fair value of derivatives are either offset against the change in fair value of the hedged assets, liabilities, or firm commitments through earnings, or recognized in other comprehensive income, which is a component of equity. The ineffective portion of a derivative s change in fair value is immediately recognized in earnings.

The Company held one interest rate contract instrument at December 31, 2009. The Company did not use hedge accounting for this instrument. The Company held one interest rate swap at September 30, 2010, which has been accounted for as a cash flow hedge as more fully described in footnote 6 below.

Stock Based Compensation

ASC Topic 718, *Compensation Stock Compensation* (referred to as ASC Topic 718 and formerly known as FASB 123R), requires us to recognize an expense for the fair value of equity-based compensation awards. Grants of stock options, restricted stock, restricted stock units and performance units under our equity incentive award plans are accounted for under ASC Topic 718. Our compensation committee will regularly consider the accounting implications of significant compensation decisions, especially in connection with decisions that relate to our equity incentive award plans and programs.

Notes to Consolidated Financial Statements (Continued)

(Unaudited and in thousands, except square footage and share data)

Income Taxes

Our taxable income prior to the completion of our IPO is reportable by the members of the limited liability companies that comprise our predecessor. Our property-owning subsidiaries are limited liability companies and are treated as pass-through entities for income tax purposes. Accordingly, no provision has been made for federal income taxes in the accompanying consolidated financial statements for the activities of these entities.

We have elected to be taxed as a REIT under the Internal Revenue Code of 1986, as amended (IRC) commencing with our initial taxable year. To qualify as a REIT, we are required to distribute at least 90% of our REIT taxable income to our stockholders and meet the various other requirements imposed by the IRC relating to such matters as operating results, asset holdings, distribution levels and diversity of stock ownership. Provided we qualify for taxation as a REIT, we are generally not subject to corporate level income tax on the earnings distributed currently to our stockholders that we derive from our REIT qualifying activities. If we fail to qualify as a REIT in any taxable year, and are unable to avail ourselves of certain savings provisions set forth in the IRC, all of our taxable income would be subject to federal income tax at regular corporate rates, including any applicable alternative minimum tax.

We have elected, together with one of our subsidiaries, to treat such subsidiary as a taxable REIT subsidiary (TRS) for federal income tax purposes. Certain activities that we undertake must be conducted by a TRS, such as non-customary services for our tenants, and holding assets that we cannot hold directly. A TRS is subject to federal and state income taxes.

The Company is subject to the statutory requirements of the state in which it conducts business.

Fair Value of Assets and Liabilities

Under GAAP, the Company is required to measure certain financial instruments at fair value on a recurring basis. In addition, the Company is required to measure other financial instruments and balances at fair value on a non-recurring basis (e.g., carrying value of impaired real estate and long-lived assets). Fair value is defined as the price that would be received upon the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The GAAP fair value framework uses a three-tiered approach. Fair value measurements are classified and disclosed in one of the following three categories:

Level 1: unadjusted quoted prices in active markets that are accessible at the measurement date for identical assets or liabilities;

Level 2: quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-derived valuations in which significant inputs and significant value drivers are observable in active markets; and

Level 3: prices or valuation techniques where little or no market data is available that requires inputs that are both significant to the fair value measurement and unobservable.

When available, the Company utilizes quoted market prices from an independent third-party source to determine fair value and classifies such items in Level 1 or Level 2. In instances where the market for a financial instrument is not active, regardless of the availability of a nonbinding quoted market price, observable inputs might not be relevant and could require the Company to make a significant adjustment to derive a fair value measurement. Additionally, in an inactive market, a market price quoted from an independent third party may rely more on models with inputs based on information available only to that independent third party. When the Company determines the market for a financial instrument owned by the Company to be illiquid or when market transactions for similar instruments do not appear orderly, the Company uses several valuation sources (including internal valuations, discounted cash flow analysis and quoted market prices) and establishes a fair value by assigning weights to the various valuation sources.

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Notes to Consolidated Financial Statements (Continued)

(Unaudited and in thousands, except square footage and share data)

Changes in assumptions or estimation methodologies can have a material effect on these estimated fair values. In this regard, the derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases, may not be realized in an immediate settlement of the instrument.

The Company considers the following factors to be indicators of an inactive market: (i) there are few recent transactions, (ii) price quotations are not based on current information, (iii) price quotations vary substantially either over time or among market makers (for example, some brokered markets), (iv) indexes that previously were highly correlated with the fair values of the asset or liability are demonstrably uncorrelated with recent indications of fair value for that asset or liability, (v) there is a significant increase in implied liquidity risk premiums, yields, or performance indicators (such as delinquency rates or loss severities) for observed transactions or quoted prices when compared with the Company s estimate of expected cash flows, considering all available market data about credit and other nonperformance risk for the asset or liability, (vi) there is a wide bid-ask spread or significant increase in the bid-ask spread, (vii) there is a significant decline or absence of a market for new issuances (that is, a primary market) for the asset or liability or similar assets or liabilities, and (viii) little information is released publicly (for example, a principal-to-principal market).

The Company considers the following factors to be indicators of non-orderly transactions: (i) there was not adequate exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities under current market conditions, (ii) there was a usual and customary marketing period, but the seller marketed the asset or liability to a single market participant, (iii) the seller is in or near bankruptcy or receivership (that is, distressed), or the seller was required to sell to meet regulatory or legal requirements (that is, forced), and (iv) the transaction price is an outlier when compared with other recent transactions for the same or similar assets or liabilities.

In August 2009, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2009-05, *Fair Value Measurements and Disclosures* (Topic 820), *Measuring Liabilities at Fair Value.* This update provides amendments to the Accounting Standard Codification (ASC) for the fair value measurement of liabilities. In circumstances in which a quoted price in an active market for the identical liability is not available, the reporting entity is required to measure fair value using (i) a valuation technique that uses the quoted price of the identical liability when traded as an asset or quoted prices for similar liabilities when traded as assets, or (ii) another valuation technique that is consistent with the principles of fair value measurement, such as the income approach or the market approach. The amendments in this update also clarify that when estimating the fair value of a liability, a reporting entity is not required to include a separate input or adjustment to other inputs relating to the existence of a restriction that prevents the transfer of the liability. These amendments to the ASC are effective upon issuance and did not have a significant impact on the combined financial statements of the Company.

The Company s interest rate contract and interest rate cap agreements are classified as Level 2 and their fair value is derived from estimated values obtained from the counterparties based on observable market data for similar instruments.

Unrealized losses associated with Level 2 liabilities was $34 for the three months ended September 30, 2010. Unrealized gains associated with Level 2 liabilities was $347 for the nine months ended September 30, 2010. Unrealized gains associated with Level 2 liabilities were $104 and $208 for the three and nine months ended September 30, 2009, respectively. The unrealized loss associated with Level 2 liabilities for the three months ended September 30, 2010 relates to an interest rate swap which has been accounted for as a cash flow hedge, therefore changes in the fair value of that derivative are recognized in other comprehensive income, which is a component of equity.

3. Investment in Real Estate

As described above, we acquired GLB Encino, LLC, Glenborough Tierrasanta, LLC, and Hudson Capital, LLC as part of the formation transactions in connection with our IPO for approximately $89.0 million. The results of operations for each of the acquired entities are included in our consolidated statements of operations only from the date of acquisition. The following table represents our preliminary purchase price allocation for these acquisitions.

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Notes to Consolidated Financial Statements (Continued)

(Unaudited and in thousands, except square footage and share data)

	GLB Encino, LLC and Glenborough Tierrasanta, LLC	Hudson Capital, LLC	Total
Consideration paid			
Issuance of common shares or common operating partnership units	$ 3,019	$ 9,000	$ 12,019
Issuance of preferred operating partnership units	12,475		12,475
Cash consideration	7,200		7,200
Debt assumed	57,300		57,300
Total consideration paid	$ 79,994	$ 9,000	$ 88,994
Allocation of consideration paid			
Investment in real estate, net	$ 72,978	$ 255	$ 73,233
Lease intangibles, net	6,570		6,570
Goodwill		8,754	8,754
Leasing costs	1,940		1,940
Fair market favorable debt value	280		280
Below- market leases	(1,062)		(1,062)
Cash		23	23
Other liabilities assumed, net	(712)	(32)	(721)
Total consideration paid	$ 79,994	$ 9,000	$ 88,994

As described above, we acquired the Del Amo Office property and underlying ground sublease on August 16, 2010 and the 9300 Wilshire Boulevard office building and underlying ground lease on August 24, 2010. The results of operations for each of these acquisitions are included in our consolidated statements of operations only from the date of acquisition. The following table represents our preliminary purchase price allocation.

	Del Amo Office	9300 Wilshire	Total
Consideration paid			
Cash consideration	$ 27,327	$ 14,684	$ 42,011
Total consideration paid	$ 27,327	$ 14,684	$ 42,011
Allocation of consideration paid			
Investment in real estate, net	$ 18,000	$ 10,718	$ 28,718
Lease intangibles, net	2,118	677	2,795
Leasing costs	558	198	756
Below-market ground lease	4,198	2,822	7,020
Above-market leases	2,626	689	3,315
Below-market leases		(104)	(104)
Other liabilities acquired, net	(173)	(316)	(489)

Total consideration paid	$ 27,327	$ 14,684	$ 42,011

The table below shows the pro forma financial information (unaudited) for the nine months ended September 30, 2010 and 2009 as if all properties had been acquired as of January 1, 2010 and 2009.

	Nine Months Ended September, 30	
	2010	**2009**
Total revenues	$ 49,621	$ 45,014
Net income	$ 2,061	$ 1,702

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Notes to Consolidated Financial Statements (Continued)

(Unaudited and in thousands, except square footage and share data)

4. Lease Intangibles

The following summarizes our deferred leasing cost and lease intangibles as of:

	September 30, 2010	December 31, 2009
Above-market leases	$ 8,714	$ 3,111
Lease in-place	16,950	10,503
Below-market ground leases	7,020	
Other lease intangibles	10,883	8,539
Lease commissions	6,048	4,571
	49,615	26,724
Accumulated amortization	(10,298)	(7,997)
Acquired lease intangible assets, net	$ 39,317	$ 18,727
Below-market leases	$ 15,335	14,169
Accumulated accretion	(3,321)	(2,533)
Acquired lease intangible liabilities, net	$ 12,014	11,636

5. Notes Payable

Senior Secured Revolving Credit Facility

In conjunction with our IPO and formation transactions, we entered into a $200.0 million secured revolving credit facility with a group of lenders for which an affiliate of Barclays Capital Inc. acts as administrative agent and joint lead arranger and affiliates of Merrill Lynch, Pierce, Fenner & Smith Incorporated act as syndication agent and joint lead arranger. The credit facility bears interest at a rate per annum equal to LIBOR plus 325 basis points to 400 basis points, depending on our leverage ratio, provided that LIBOR is subject to a floor of 1.50%. The secured revolving credit facility contains an accordion feature that allows us to increase the availability by $50.0 million, to $250.0 million, under specified circumstances.

The amount available for us to borrow under the facility will be subject to the lesser of a percentage of the appraisal value of our properties that form the borrowing base of the facility and a minimum implied debt service coverage ratio. Our ability to borrow under the facility is subject to ongoing compliance with a number of customary restrictive covenants, including:

a maximum leverage ratio (defined as consolidated total indebtedness to total asset value) of 0.60:1.00;

a minimum fixed charge coverage ratio (defined as consolidated earnings before interest, taxes; depreciation and amortization to consolidated fixed charges) of 1.75:1.00;

a maximum consolidated floating rate debt ratio (defined as consolidated floating rate indebtedness to total asset value) of 0.25:1.00;

a maximum recourse debt ratio (defined as recourse indebtedness other than indebtedness under the revolving credit facility but including unsecured lines of credit to total asset value) of 0.15:1.00; and

a minimum tangible net worth equal to at least 85% of our tangible net worth at the closing of our IPO plus 75% of the net proceeds of any additional equity issuances.

Notes to Consolidated Financial Statements (Continued)

(Unaudited and in thousands, except square footage and share data)

The following table sets forth information as of September 30, 2010 with respect to our outstanding indebtedness. The $115.0 million note secured by the Sunset Gower property and $37.5 million note secured by the 875 Howard Street property summarized below were repaid from proceeds of the IPO. Approximately $75.0 million is available to us under the secured credit facility.

Debt	Outstanding September 30, 2010	Outstanding December 31, 2009	Interest Rate (1)	Maturity Date
Mortgage loan secured by Sunset Bronson	$ 37,000	$ 37,000	LIBOR+3.65%	04/30/11
Mortgage loan secured by First Financial	43,000		5.34%	12/01/11
Mortgage loan secured by Tierrasanta	14,300		5.62%	12/01/11
Mortgage loan secured by Sunset Gower		115,000	LIBOR+2.75%	03/14/10
Construction loan secured by 875 Howard Street		37,518	LIBOR+1.75%	02/13/11
Secured Revolving Credit Facility			LIBOR+3.25%-4.00%	06/29/13
Subtotal	$ 94,300	$ 189,518		
Unamortized Loan Premium (2)	(231)			
Total	$ 94,069	$ 189,518		

(1) Interest rates with respect to indebtedness are calculated on the basis of a 360-day year for the actual days elapsed. The indebtedness encumbering the Sunset Bronson property is floating rate indebtedness. It was subject to a collar on the LIBOR portion of the interest rate of not less than 2.55% and no greater than 3.87% until September 1, 2010. From and after June 1, 2010, the applicable interest rate must be at least 5.90% per annum, unless a hedge agreement is entered into in connection with the extension of the loan. A new secured interest rate contract with respect to this loan went effective upon the closing of the IPO and related formation transaction on June 29, 2010, which swapped one-month LIBOR to a fixed rate of 0.75%.

(2) Represents non-cash mark-to-market adjustment on fixed rate debt associated with the First Financial and Tierrasanta loans.

6. Interest Rate Contracts

The indebtedness encumbering the Sunset Gower property and Technicolor Building until its repayment on June 29, 2010 in connection with the IPO and related formation transactions, was subject to an interest rate contract, effective as of September 15, 2008, capping one-month LIBOR at 4.75% on the notional amount and on terms identical to the principal amount and terms of the mortgage loan. That interest rate contract expired on September 15, 2009. Another interest rate contract capping one-month LIBOR at 4.75% on the notional amount and on terms identical to the principal amount and terms of the mortgage loan was purchased and went effective September 15, 2009 and covered the period through March 15, 2010. The fair market value of that interest rate cap agreement at September 30, 2010 (having expired on March 15, 2010) and December 31, 2009 was $0.

The indebtedness encumbering the Sunset Bronson property was subject to a collar on the LIBOR portion of the interest rate of not less than 2.55% and no greater than 3.87% until September 1, 2010. From and after June 1, 2010, the applicable interest rate became 5.90% per annum, until a new secured interest rate contract went effective upon the closing of the IPO and related formation transaction on June 29, 2010, which swapped one-month LIBOR to a fixed rate of 0.75%. The interest rate contract for Sunset Bronson fixes one-month LIBOR on the full $37.0 million notional loan amount through April 30, 2011 on terms identical to the terms of the mortgage loan. The fair market value of these interest contracts at September 30, 2010 and December 31, 2009 was $112 and $425 liability position, respectively.

7. Future Minimum Base Rents and Lease Payments Future Minimum Rents

Our properties are leased to tenants under operating leases with initial term expiration dates ranging from 2010 to 2020. Approximate future combined minimum rentals (excluding tenant reimbursements for operating expenses and without regard to cancellation options) for properties at September 30, 2010 are as follows for the years/periods ended December 31. The table does not include rents under leases at our media and entertainment properties with terms of one year or less.

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Notes to Consolidated Financial Statements (Continued)

(Unaudited and in thousands, except square footage and share data)

2010 (three months ending December 31, 2010)	$ 6,156
2011	26,312
2012	25,268
2013	24,365
2014	21,799
2015	21,223
Thereafter	65,512
Total future minimum rents	$ 190,635

Future Minimum Lease Payments

In conjunction with the acquisition of the Sunset Gower Property, our subsidiary, SGS Realty II, LLC, assumed a ground lease agreement (expiring March 31, 2060) for a portion of the land with an unrelated party. Commencing September 1, 2007, the monthly rent increased to $15, whereas the monthly rent totaled $14 at the time of acquisition. The rental rate is subject to adjustment in September 2011 and every seven years thereafter. In conjunction with the acquisition of the Del Amo Office building, our subsidiary, Hudson Del Amo Office, LLC, assumed a ground sublease (expiring June 30, 2049) with an unrelated party. Rent under the ground sublease is $1.00 per year, with sublessee being responsible for all impositions, insurance premiums, operating charges, maintenance charges, construction costs and other charges, costs and expenses that arise or may be contemplated under any provisions of the ground sublease. In conjunction with the acquisition of the 9300 Wilshire Boulevard building, our subsidiary, Hudson 9300 Wilshire, LLC, assumed a ground lease (expiring August 14, 2032) with an unrelated party. Minimum rent under the ground lease is $75 per year (additional rent under this lease of 6% of gross rentals less minimum rent, as defined in such lease, is not included in this amount).

The following table provides information regarding our future minimum lease payments at September 30, 2010 under these lease agreements.

2010 (three months ending December 31, 2010)	$ 64
2011	256
2012	256
2013	256
2014	256
2015	256
Thereafter	9,265
Total future minimum rents	$ 10,609

8. Fair Value of Financial Instruments

The carrying values of cash and cash equivalents, restricted cash, receivables, payables, and accrued liabilities are reasonable estimates of fair value because of the short-term maturities of these instruments. Fair values for notes payable are estimates based on rates currently prevailing for similar instruments of similar maturities. The estimated fair values of interest-rate contract/cap arrangements were derived from estimated values obtained from the counterparties based on observable market data for similar instruments.

	September 30, 2010		December 31, 2009	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Notes payable	$ 94,069	$ 93,971	$ 189,518	$ 188,389
Interest rate contracts	112	112	425	425
	$ 94,181	$ 94,083	$ 189,943	$ 188,814

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Notes to Consolidated Financial Statements (Continued)

(Unaudited and in thousands, except square footage and share data)

9. Equity

Non-controlling Interests

Non-controlling common partnership interests in our operating partnership relate to interests in the partnership that are not owned by us. Non-controlling interests consisted of 2,610,941 common units of partnership interest in our operating partnership, or common units, and represented approximately 10.5% of our operating partnership at September 30, 2010. Common units and shares of our common stock have essentially the same economic characteristics as they 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 common stock, or, at our election, shares of our common stock on a one-for-one basis.

Non-controlling series A preferred partnership interests in our operating partnership relate to 499,014 series A preferred units of partnership interest our operating partnership, or series A preferred units, that are not owned by us. These series A preferred units are entitled to preferential distributions at a rate of 6.25% per annum on the liquidation preference of $25.00 per unit and are convertible at the option of the holder into common units or redeemable into cash or, at our option, exchangeable for registered shares of common stock, in each case after an initial holding period of not less than three years from the consummation of this offering. For a description of the conversion and redemption rights of the series A preferred units, please see Description of the Partnership Agreement of Hudson Pacific Properties, L.P.-Material Terms of Our Series A Preferred Units in our June 23, 2010 Prospectus.

The table below represent our condensed consolidated statements of equity and non-controlling series A preferred partnership interests:

	Common Shares	Stock Amount	Additional Paid in Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	Non-controlling Interests Unitholders in the Operating Partnership	Members real estate Equity	Non-controlling Interests Members in consolidated entities	Total	Non-controlling Interests Series A Cumulative Redeemable Preferred Units
Balance, January 1, 2010		$	$	$		$	$ 223,240	$ 3,348	$ 226,588	$
Contributions			8				3,645		3,653	
Distributions			(79)				(1,624)		(1,703)	
Proceeds from sale of common stock, net of Underwriter s discount	14,720,000	147	232,574						232,721	
Proceeds from private placement	1,176,471	12	19,988						20,000	
Issuance of restricted stock	265,291	2	(2)							
Shares repurchased			(1)						(1)	
Issuance of Series A Cumulative Redeemable Preferred Units for acquisition of properties										12,475
Issuance of common units for acquisition of properties						12,019			12,019	
Transaction related costs			(7,169)						(7,169)	
Declared Dividend			(2,085)						(2,085)	
								(828)	(828)	

Acquisition of non-controlling members Interest										
Amortization of stock based compensation				375						
Net income (loss)				(2,323)		(277)	283	(29)	(2,346)	195
Cash Flow Hedge Adjustment					(30)	(4)			(34)	
Comprehensive Loss									(2,380)	
Exchange of Member s equity for common stock and units	6,050,037	61	173,390			54,584	(225,544)	(2,491)		
Balance, September 30, 2010	22,211,799	$ 222	$ 416,624	$ (1,948)	$ (30)	$ 66,322	$	$	$ 481,190	$ 12,670

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(Unaudited and in thousands, except square footage and share data)

Dividends

During the third quarter for 2010, we declared two dividends on our common stock and non-controlling common partnership interests of $0.0021 per share and unit for the period from June 29, 2010, to June 30, 2010, and $0.095 per share and unit for the third quarter ending September 30, 2010. We also declared two dividends on our series A preferred partnership interests of $0.0086 per unit for the period from June 29, 2010, to June 30, 2010, and $0.3906 per unit for the third quarter ending September 30, 2010. The dividends were declared on September 22, 2010, to holders of record on September 30, 2010.

Taxability of Dividends

Earnings and profits, which determine the taxability of distributions to stockholders, 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

In connection with entering into the employment arrangements effective as of closing of the IPO, Messrs. Coleman, Stem, Lammas, Barton, Shimoda, and certain non-executive employees and directors were granted 265,309 restricted shares of our common stock at our initial offering price of $17.00 per restricted share resulting in $4.5 million total compensation expense. These restricted stock awards will vest in three equal, annual installments on each of the first three anniversaries of the date of the IPO, subject to the executive s continued employment. We will recognize compensation expense for these shares on a straight-line basis over the vesting period based on the fair value of the award on the date of grant. None of the restricted shares were vested at September 30, 2010.

10. Related Party Transactions

Until the IPO and related formation transactions, the media and entertainment properties owned by our predecessor were managed by Hudson Studios Management, LLC and our City Plaza office property was managed by Hudson OP Management, LLC, both of which were affiliates of our predecessor.

Upon acquisition of the Sunset Gower property, the Sunset Gower property owning subsidiary entered into a five year management agreement with Hudson Studios Management, LLC, an affiliate of our predecessor, to pay a monthly management fee equal to $54 for the first 24 months of the term and $42 for the remaining 36 months. For the nine months ended September 30, 2010 and 2009, management fees of approximately $250 and $325, respectively, had been incurred. In addition, Hudson Studios Management, LLC was entitled to a construction management fee of $300 plus 5% of the hard costs in association with other future developments. As of September 30, 2010 and December 31, 2009, $300 of construction management fees had been capitalized to construction in progress.

Upon acquisition of the Sunset Bronson property, the Sunset Bronson property owning subsidiary entered into an agreement with Hudson Studios Management, LLC to pay a management fee equal to $33 per month through December 31, 2009 and $25 per month thereafter for the remaining five-year term. For the nine months ended September 30, 2010 and 2009, approximately $150 and $200, respectively, of management fees had been incurred.

Upon acquisition of the City Plaza property, the City Plaza property owning subsidiary entered into an agreement with Hudson OP Management, LLC to pay a management fee equal to $10 per month. For the nine months ended September 30, 2010 and 2009, approximately $60 of management fees had been incurred.

In connection with the IPO and the formation transactions, Hudson Capital, LLC, certain investment funds affiliated with Farallon Capital Management, L.L.C., which we refer to as the Farallon Funds, and certain other contributors advanced or incurred an aggregate of approximately $2.6 million in organizational and other similar expenses. These funds were advanced or incurred with the understanding that they would be repaid out of the proceeds of the completed public offering. Accordingly, upon consummation of the IPO, we repaid approximately $0.6 million of such advances to Hudson Capital, LLC and approximately $1.7 million of such advances to the Farallon Funds. The remaining approximately $0.3 million of such advances were repaid to unaffiliated third parties. We are in the process of completing reconciliations of property prorations and costs advanced or incurred by the contributors in connection with the IPO and formation transactions.

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(Unaudited and in thousands, except square footage and share data)

11. Commitments and Contingencies

Legal

We are subject to certain legal proceedings and claims arising in connection with our business. We believe, based in part upon consultation with legal counsel, that the ultimate resolution of all such claims will not have a material adverse effect on our combined results of operations, financial position, or cash flows.

Commitments

On December 1, 2008, we entered into an agreement with a third party manager relating to our City Plaza property. The City Plaza manager earned the greater of $4 per month or 1.25% of gross income collected from the City Plaza property for the preceding month. The agreement also provided for a construction management fee based upon an incremental scale, as defined in the agreement. This ag