

PS BUSINESS PARKS INC/CA
Form 10-K
February 26, 2019
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2018.

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 1-10709

PS BUSINESS PARKS, INC.

(Exact name of registrant as specified in its charter)

California	95-4300881
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

701 Western Avenue, Glendale, California 91201-2349

(Address of principal executive offices) (Zip Code)

818-244-8080

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, \$0.01 par value per share Depositary Shares Each Representing 1/1,000 of a Share of	New York Stock Exchange
5.750% Cumulative Preferred Stock, Series U, \$0.01 par value per share Depositary Shares Each Representing 1/1,000 of a Share of	New York Stock Exchange
5.700% Cumulative Preferred Stock, Series V, \$0.01 par value per share Depositary Shares Each Representing 1/1,000 of a Share of	New York Stock Exchange
5.200% Cumulative Preferred Stock, Series W, \$0.01 par value per share Depositary Shares Each Representing 1/1,000 of a Share of	New York Stock Exchange
5.250% Cumulative Preferred Stock, Series X, \$0.01 par value per share Depositary Shares Each Representing 1/1,000 of a Share of	New York Stock Exchange
5.200% Cumulative Preferred Stock, Series Y, \$0.01 par value per share	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

None

(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes No

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§232.405) is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of June 30, 2018, the aggregate market value of the registrant's common stock held by non-affiliates of the registrant was \$2,553,972,195 based on the closing price as reported on that date.

Number of shares of the registrant's common stock, par value \$0.01 per share, outstanding as of February 18, 2019 (the latest practicable date): 27,362,101.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive proxy statement to be filed in connection with the Annual Meeting of Shareholders to be held in 2019 are incorporated by reference into Part III of this Annual Report on Form 10-K.

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PART I

ITEM 1. BUSINESS

Forward-Looking Statements

Forward-looking statements, within the meaning of the Private Securities Litigation Reform Act of 1995, are made throughout this Annual Report on Form 10-K. For this purpose, any statements contained herein that are not statements of historical fact may be deemed to be forward-looking statements. Without limiting the foregoing, the words “may,” “believes,” “anticipates,” “plans,” “expects,” “seeks,” “estimates,” “intends” and similar expressions are intended to identify forward-looking statements. There are a number of important factors that could cause the results of the Company to differ materially from those indicated by such forward-looking statements, including but not limited to (a) changes in general economic and business conditions; (b) decreases in rental rates or increases in vacancy rates/failure to renew or replace expiring leases; (c) tenant defaults; (d) the effect of the recent credit and financial market conditions; (e) our failure to maintain our status as a real estate investment trust (a “REIT”) under the Internal Revenue Code of 1986, as amended (the “Code”); (f) the economic health of our customers; (g) increases in operating costs; (h) casualties to our properties not covered by insurance; (i) the availability and cost of capital; (j) increases in interest rates and its effect on our stock price; and (k) other factors discussed under the heading Item 1A, “Risk Factors.” In light of the significant uncertainties inherent in the forward-looking statements included herein, the inclusion of such information should not be regarded as a representation by us or any other person that our objectives and plans will be achieved. Moreover, we assume no obligation to update these forward-looking statements to reflect actual results, changes in assumptions or changes in other factors affecting such forward-looking statements, except as required by law.

The Company

PS Business Parks, Inc. (“PSB”) is a fully-integrated, self-advised and self-managed REIT that owns, operates, acquires and develops commercial properties, primarily multi-tenant industrial, flex and office space. Substantially all of PSB’s assets are held, and its business conducted, through PS Business Parks, L.P. (the “OP”), a California limited partnership. PSB has full, exclusive, and complete control of the OP as the sole general partner and, as of December 31, 2018, owned 78.9% of the common partnership units, with Public Storage (“PS”) owning the remainder. Assuming issuance of PSB common stock upon redemption of the common partnership units held by PS, PS would own 41.7% (or 14.5 million shares) of the outstanding shares of the Company’s common stock.

Unless otherwise indicated or unless the context requires otherwise, all references to “the Company,” “we,” “us,” “our” and similar references mean PS Business Parks, Inc. and its subsidiaries, including the OP and our consolidated joint venture.

As of December 31, 2018, we owned and operated 28.2 million rentable square feet of commercial space, comprising 96 business parks, in California, Texas, Virginia, Florida, Maryland and Washington. The Company focuses on owning concentrated business parks which provide the Company with the greatest flexibility to meet the needs of its customers. Along with the commercial space, we also have a 95.0% interest in a 395-unit apartment complex. The Company also manages 450,000 rentable square feet on behalf of PS.

History of the Company: The Company was formed in 1990 as a California corporation. Through a series of transactions between January, 1997 to March, 1998, the Company was renamed “PS Business Parks, Inc.” and became a publicly held, fully integrated, self-advised and self-managed REIT having interests in commercial real estate held through our OP.

Principal Business Activities

We are in the commercial property business, with 96 business parks consisting of multi-tenant industrial, flex and office space. The Company owns 17.5 million square feet of industrial space that has characteristics similar to the warehouse component of the flex space as well as ample dock access. We own 6.7 million square feet of flex space, representing industrial buildings that are configured with a combination of warehouse and office space and can be designed to fit a wide variety of uses. The warehouse component of the flex space has a number of uses including light manufacturing and assembly, storage and warehousing, showroom, laboratory, distribution and research and development activities. The office component of flex space is complementary to the warehouse component by enabling businesses to accommodate management and production staff in the same facility. In addition, the Company owns 4.0 million square feet of low-rise office space, generally either in business parks that combine office and flex space or in submarkets where the market demand is more office focused.

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We generally seek to operate in multi-tenant buildings in multi-building business parks which accommodate various businesses and uses. Our business parks average 10 buildings and 800,000 rentable square feet per park, located on parcels of various sizes, ranging from one to 49 buildings and 12,000 to 3.5 million square feet of rentable space. Parking is generally open but in some instances is covered. The ratio of parking spaces to rentable square feet generally ranges from two to six per thousand square feet depending upon the use of the property and its location. Office space generally requires a greater parking ratio than most industrial uses.

The customer base for our facilities is diverse. The portfolio can be bifurcated into those facilities that service small to medium-sized businesses and those that service larger businesses. Approximately 35.1% of in-place rents from the portfolio are derived from facilities that generally serve small to medium-sized businesses. A property in this facility type is typically divided into units under 5,000 square feet and leases generally range from one to three years. The remaining 64.9% of in-place rents from the portfolio are generally derived from facilities that serve larger businesses, with units 5,000 square feet and larger. The Company also has several customers that lease space in multiple buildings and locations. The U.S. Government is the largest customer with multiple leases encompassing approximately 681,000 square feet and 4.0% of the Company's annualized rental income.

We operate in six states and we may expand our operations to other states or reduce the number of states in which we operate. However, we have no current plans to expand into additional markets or exit existing markets. Properties are acquired for both income and capital appreciation potential; we place no limitation on the amount that can be invested in any specific property.

The Company owns land which may be used for the future development of commercial properties including approximately 14.0 acres in Dallas, Texas and 6.4 acres in Northern Virginia.

See "Objectives and Strategies" below for further information.

Our principal executive offices are located at 701 Western Avenue, Glendale, California 91201-2349, and our telephone number is (818) 244-8080. We maintain a website with the address www.psbusinessparks.com. The information contained on our website is not a part of, or incorporated by reference into, this Annual Report on Form 10-K. We make available free of charge through our website our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K, and amendments to these reports, as soon as reasonably practicable after we electronically file or furnish such material to the Securities and Exchange Commission (the "SEC").

Recent Company Developments

Acquisition of Real Estate Facilities: On June 8, 2018, we acquired two multi-tenant industrial parks aggregating 1.1 million rentable square feet in Springfield, Virginia, for a net purchase price of \$143.8 million. The occupancy rate of these two parks has increased from 76.1% on the date of acquisition to 76.7% as of December 31, 2018.

Development of Multifamily Real Estate: In 2015, we demolished one of our existing office buildings located within our 628,000 square foot office park known as “The Mile” in Tysons, Virginia, and completed a 395-unit multifamily building (“Highgate”) in 2017, for an aggregate cost of \$115.4 million, including the fair value of the land. We leveraged the expertise of a well-regarded local developer and operator of multifamily real estate, who holds a 5.0% interest in the joint venture that owns this development. We are also seeking entitlements to develop an additional multifamily apartment complex on a site held by a 123,000 square foot vacant building we own located within The Mile. See “Objectives and Strategies” below for further information regarding our development and redevelopment activities.

Sales of Real Estate Facilities: On March 5, 2018, we sold Corporate Pointe Business Park, a park consisting of five multi-tenant office buildings totaling 161,000 square feet, located in Orange County, California, for net sale proceeds of \$41.7 million, which resulted in a gain of \$26.8 million. On April 18, 2018, we sold Orange County Business Center, a park consisting of five multi-tenant office buildings totaling 437,000 square feet located in Orange County, California, for net sale proceeds of \$73.3 million, which resulted in a gain of \$50.6 million. On April 30, 2018, we sold Northgate Business Park, a park consisting of seven multi-tenant flex buildings totaling 194,000 square feet located in Dallas, Texas, for net sale proceeds of \$11.8 million, which resulted in a gain of \$7.9 million. On October 31, 2018, we sold Orangewood Office Park, a park consisting of two multi-tenant office buildings totaling 107,000 square feet located in Orange County, California, for net sale proceeds of \$18.3 million, which resulted in a gain of \$8.2 million.

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Tax and Corporate Structure

For all periods presented herein, we have elected REIT status under the Code. As a REIT, we generally do not incur federal income tax if we distribute substantially all of our “REIT taxable income” (generally, net rents and gains from real property, dividends, and interest) each year, and if we meet certain organizational and operational rules. To the extent that we continue to qualify as a REIT, we will not be taxed, with certain limited exceptions, on the “REIT taxable income” that is currently distributed to our shareholders. We believe we have met these requirements in all periods presented herein, and we expect to continue to elect and qualify as a REIT.

PSB is structured as an umbrella partnership REIT (“UPREIT”), with substantially all of our activities conducted through the OP. We acquired interests in certain properties from PS during PSB’s initial formation in exchange for operating partnership units, which allowed PS to defer the recognition of a tax gain on the contributed properties. We have the ability to offer similar tax-efficient transactions to potential sellers of real estate in the future.

We are the sole general partner of the OP, which has equity in the form of common partnership units and preferred partnership units that are identical as to terms, coupon rates, and liquidation amounts as our preferred shares outstanding. As of December 31, 2018, we owned 78.9% of the common partnership units of the OP and 100% of the preferred partnership units. The remainder of the common partnership units are owned by PS. The common units owned by PS may be redeemed, subject to certain limitations, for shares of our common stock on a one-for-one basis or, at our option, an equivalent value in cash.

The Company’s interest in the OP entitles it to share in cash distributions from, and the profits and losses of, the OP in proportion to the Company’s economic interest in the OP (apart from tax allocations of profits and losses to take into account pre-contribution property appreciation or depreciation). The Company, since 1998, has paid per share dividends on its common and preferred stock that track, on a one-for-one basis, the amount of per unit cash distributions the Company receives from the OP in respect of the common and preferred partnership units in the OP that are owned by the Company.

As the general partner of the OP, the Company has the exclusive responsibility under the Operating Partnership Agreement to manage and conduct the business of the OP. The OP is responsible for, and pays when due, its share of all administrative and operating expenses of the properties it owns.

Common Officers and Directors with PS

Ronald L. Havner, Jr., Chairman of the Company, is also the Chairman of the Board of Trustees of PS. Joseph D. Russell, Jr. is a director of the Company and also President and Chief Executive Officer of PS. Gary E. Pruitt, an independent director of the Company, is also a trustee of PS. Other employees of PS render services to the Company pursuant to a cost sharing and administrative services agreement.

Common Services Provided to and by PS

We manage industrial, office, and retail facilities in the United States for PS under either the “Public Storage” or “PS Business Parks” names (the “PS Management Agreement”). Under PS’s supervision, we coordinate and assist in rental and marketing activities, property maintenance and other operational activities, including the selection of vendors, suppliers, employees and independent contractors. Management fee revenue derived from the PS Management Agreement totaled \$407,000, \$506,000 and \$518,000 for the years ended December 31, 2018, 2017 and 2016, respectively.

PS also provides property management services for the self-storage component of two assets owned by the Company. Management fee expenses under the contract were \$96,000, \$92,000 and \$86,000 for the years ended December 31, 2018, 2017 and 2016, respectively.

Pursuant to a cost sharing agreement, we share certain administrative services, corporate office space, and certain other third party costs with PS which are allocated based upon fair and reasonable estimates of the cost of the services expected to be provided. We reimbursed PS \$1.2 million, \$1.3 million and \$1.1 million, respectively, in the years ended December 31, 2018, 2017 and 2016 for costs paid on our behalf, while PS reimbursed us \$38,000, \$31,000 and \$38,000 costs we incurred on their behalf for the years ended December 31, 2018, 2017 and 2016, respectively.

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Management

Maria R. Hawthorne leads the Company's senior management team. Ms. Hawthorne is President and Chief Executive Officer of the Company. The Company's senior management includes: John W. Petersen, Executive Vice President and Chief Operating Officer; Jeffrey D. Hedges, Executive Vice President and Chief Financial Officer; Trenton A. Groves, Senior Vice President and Chief Accounting Officer; Christopher M. Auth, Vice President (Washington Metro Division); Coby A. Holley, Vice President, Investments; Stuart H. Hutchison, Vice President (Southern California and Pacific Northwest Divisions); Richard E. Scott, Vice President (Northern California Division); Eugene Uhlman, Vice President, Construction Management; and David A. Vicars, Vice President (Southeast Division, which includes Florida and Texas).

Competition

Our properties compete for tenants with similar properties located in our markets primarily on the basis of location, rent charged, services provided and the design and condition of improvements. Competition in the market areas we operate in is significant and has from time to time negatively impacted occupancy levels and rental rates of, and increased the operating expenses of, certain of our properties. Competition may be accelerated by any increase in availability of funds for investment in real estate, because barriers to entry can be relatively low for those with the necessary capital. The demand for space in our markets is impacted by general economic conditions, which can affect the local competition for tenants. Sublease space and unleased developments have from time to time created competition among operators in certain markets in which the Company operates. We also compete for property acquisitions with entities that have greater financial resources than the Company.

We believe we possess several distinguishing characteristics and strategies, some of which are described below under "Objectives and Strategies," that enable us to compete effectively. In addition, we believe our personnel are among the most experienced in these real estate markets. The Company's facilities are part of a comprehensive system encompassing standardized procedures and integrated reporting and information networks.

We believe that the significant operating and financial experience of our executive officers and directors combined with the Company's capital structure, national investment scope, geographic diversity, financial stability, and economies of scale should enable us to compete effectively.

Objectives and Strategies

Our primary objective is to grow shareholder value in a risk appropriate and stable manner by maximizing the net cash flow generated by our existing properties, as well as prudently seeking growth through acquisitions and development that generate attractive returns on invested capital.

We seek to optimize the net cash flow of our existing properties by maximizing occupancy levels and rental rates, while minimizing capital expenditures and leasehold improvements. Below are the primary elements of our strategy:

Concentration in favorable markets: We believe that our properties generally are located in markets that have favorable characteristics such as above average population, job, and income growth, as well as high education levels. In addition, we believe our business parks are generally in higher barrier to entry markets that are close to critical infrastructure, middle to high income housing or universities and have easy access to major transportation arteries. We believe that these characteristics contribute to favorable cash flow stability and growth.

Standard build outs and finishes: We generally seek to configure our rentable space with standard buildouts and finishes that meet the needs of a wide variety of tenants, minimizing the need for specialized and costly tenant improvements and enabling space to be “move-in ready” quickly upon vacancy. We believe this makes our space more attractive to potential tenants, allows tenants to move in more quickly and seamlessly, and reduces the cost of capital improvements, relative to real estate operators that offer specialized finishes or build outs. Also, such flexibility facilitates our ability to offer diverse sizes and configurations to meet potential customer’s needs, as well as to change space sizes for existing customers when their needs change, at the low relative cost of a standard configuration.

Large, Diverse Parks: Our business parks are generally concentrated in large complexes of diverse buildings, with a variety of available space sizes and configurations that we can offer to tenants. We believe that this allows us to attract a greater number of potential tenants to our space and minimizes the loss of existing customers when their space requirements change.

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Smaller tenants and diverse tenant base with shorter-term leases: By concentrating on smaller spaces, we seek to reach the large number of smaller tenants in the market. We believe this focus gives us a competitive edge as most institutional owners focus on large users. Small users perceive more incremental value from the level of customer service that we offer. We also believe having smaller tenants improves our diversity of tenants across industries, which improves the stability of our cash flows. In addition, our lease term tends to be shorter, generally an average of three and a half years, which we believe allows us to more quickly capture increases in market rents in our high-growth markets. At December 31, 2018, our average space size is approximately 5,000 rentable square feet per tenant, and no individual tenant, other than the U.S. Government, represents more than 1% of our annualized rental income.

Decentralized operating strategy: Our local market management is empowered, within a prescribed decision and metrics framework, to make many leasing rate, capital, and lease term decisions in a manner which we believe maximizes the return on investment on leasing transactions. We believe this decentralized approach allows us to be more nimble and effective in our decision making, and more effectively price and market our space, relative to a more centralized approach.

Superior Service to Customers: We seek to provide a superior level of service to our customers in order to maintain occupancy and increase rental rates, as well as minimize customer turnover. The Company's property management offices are located on-site, helping the Company maintain its properties and providing customers with convenient access to management, while conveying a sense of quality, order and security. We believe that our personnel are among the most experienced and effective in the real estate industry in our markets. The Company has significant experience in acquiring properties managed by others and thereafter improving customer satisfaction, occupancy levels, retention rates and rental income by implementing established customer service programs.

In addition, we seek to expand through acquisitions or development that generate attractive returns on invested capital, as follows:

Acquire facilities in targeted markets at prudent price levels: We have a disciplined capital allocation approach, seeking to purchase properties at prices that are not in excess of the cost to develop similar facilities, which we believe reduces our risk and maximizes long term returns. We seek generally to acquire in our existing markets, which we believe have favorable growth characteristics. We also believe acquiring in our existing markets leverages our operating efficiencies. We would consider expanding to additional markets with similar favorable characteristics of our existing markets, if we could acquire sufficient scale (generally at least 2 million rentable square feet); however, we have no current plans or immediate prospects to do so.

Redevelop existing real estate facilities: Certain of our existing business parks were developed in or near areas that have been undergoing gentrification and an influx of residential development, and, as a result, certain buildings in our business parks may have higher and better uses as residential space. While residential space is generally not a core asset class for us, we will seek to identify potential candidates for redevelopment in our portfolio, and plan to leverage

the expertise and scale of existing operators and developers should we pursue redevelopment of any of our properties. For example, at The Mile in Tysons, Virginia, as noted above, we demolished an existing building and developed, with a joint venture partner, a 395-unit apartment building, and are seeking entitlements for another multifamily apartment complex to be built following demolition of an existing 123,000 square foot vacant office building. There can be no assurance as to the level of conversion opportunities throughout our portfolio in the future.

Financing Strategy

Overview of financing strategy and sources of capital: As a REIT, we generally distribute substantially all of our “REIT taxable income” to our shareholders which, relative to a taxable C corporation, limits the amount of cash flow from operations that we can retain for investment purposes. As a result, in order to expand our asset base, access to capital is important.

Our financial profile is characterized by strong credit metrics, including low leverage relative to our total capitalization and operating cash flows. Our credit profile and ratings enable us to effectively access both the public and private capital markets to raise capital. We will seek to maintain our credit profile and ratings.

Sources of capital available to us include retained cash flow, the issuance of preferred and common equity, the issuance of medium and long-term debt, joint venture financing, the sale of properties, and our revolving line of credit.

Historically, we have financed our cash investment activities primarily with retained operating cash flow and the issuance of preferred equity.

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We select from the sources of capital available to us based upon relative cost, availability and the desire for leverage, nature of the investment opportunities for which the capital will be used, as well as intangible factors such as the impact of covenants in the case of debt.

Retained Operating Cash Flow: Although we are required to generally distribute substantially all of our “REIT taxable income” to our shareholders, we have nonetheless been able to retain operating cash flow to the extent that our tax depreciation exceeds our maintenance capital expenditures. In recent years, we have retained approximately \$40 to \$60 million in operating cash flow per year.

Preferred Equity: We view preferred equity as an important source of capital over the long term, because it reduces interest rate and refinancing risks as the dividend rate is fixed and there are no refinancing requirements. In addition, the consequences of defaulting on required preferred distributions are less severe than with debt. However, rates and market conditions for the issuance of preferred securities can be volatile or inefficient from time to time. The preferred shareholders may elect two additional directors if six quarterly distributions go unpaid, whether or not consecutive. As of December 31, 2018, we have \$959.8 million in preferred securities outstanding with an average coupon rate of 5.40%.

Medium or long-term debt: We have broad powers to borrow in furtherance of our objectives. We may consider the public issuance or private placement of senior unsecured debt in the future in an effort to diversify our sources of capital.

Common equity: We believe that the market for our common equity is liquid and, as a result, common equity is a viable potential source of capital.

Tax advantaged equity: As noted above, we have the ability to offer common or preferred operating partnership units with economic characteristics that are similar to our common and preferred stock, but provide the seller the opportunity to defer the recognition of a tax gain.

Credit Facility: We have a \$250.0 million unsecured revolving line of credit (the “Credit Facility”) which we can and will use as necessary as temporary financing, along with short-term bank loans, until we are able to raise longer-term capital. As of December 31, 2018, there were no borrowings outstanding on our Credit Facility and we had no short-term bank loans.

Investments in Real Estate Facilities

As of December 31, 2018, the Company owned and operated 28.2 million rentable square feet comprised of 96 business parks in six states compared to 28.0 million rentable square feet comprised of 98 business parks at December 31, 2017. The Company also held a 95.0% interest in a 395-unit multifamily apartment complex as of December 31, 2018 and 2017.

Restrictions on Transactions with Affiliates

The Company's Bylaws provide that the Company may engage in transactions with affiliates provided that a purchase or sale transaction with an affiliate is (i) approved by a majority of the Company's independent directors and (ii) fair to the Company based on an independent appraisal or fairness opinion.

Employees

As of December 31, 2018, the Company employed 156 individuals, primarily personnel engaged in property operations.

Insurance

The Company believes that its properties are adequately insured. Facilities operated by the Company have historically been covered by comprehensive insurance, including fire, earthquake, wind damage and liability coverage from nationally recognized carriers, subject to customary levels of deductibles.

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Environmental Matters

Compliance with laws and regulations relating to the protection of the environment, including those regarding the discharge of material into the environment, has not had any material effect upon the capital expenditures, earnings or competitive position of the Company.

Substantially all of the Company's properties have received Phase I environmental reviews. Such reviews have not revealed, nor is management aware of, any probable or reasonably possible environmental costs that management believes would have a material adverse effect on the Company's business, assets or results of operations, nor is the Company aware of any potentially material environmental liability. See Item 1A, "Risk Factors" for additional information.

ITEM 1A. RISK FACTORS

In addition to the other information in our Annual Report on Form 10-K, you should consider the risks described below that we believe may be material to investors in evaluating the Company. This section contains forward-looking statements, and in considering these statements, you should refer to the qualifications and limitations on our forward-looking statements that are described in Item 1, "Business — Forward-Looking Statements."

We have significant exposure to real estate risk.

Since our business consists primarily of acquiring and operating real estate, we are subject to the risks related to the ownership and operation of real estate that can adversely impact our business and financial condition. Certain significant costs, such as mortgage payments, real estate taxes, insurance and maintenance, generally are not reduced even when a property's rental income is reduced. In addition, environmental and tax laws, interest rate levels, the availability of financing and other factors may affect real estate values and property income. Furthermore, the supply of commercial space fluctuates with market conditions.

Since we derive substantially all our income from real estate operations, we are subject to the following general risks of acquiring and owning real estate related assets that could result in reduced revenues, increased expenses, increased capital expenditures, or increased borrowings, which could negatively impact our operating results, cash flow available for distribution or reinvestment and our stock price:

- changes in the national, state and local economic climate and real estate conditions, such as oversupply of or reduced demand for commercial real estate space and changes in market rental rates;

- how prospective tenants perceive the attractiveness, convenience and safety of our properties;

- difficulties in consummating and financing acquisitions and developments on advantageous terms and the failure of acquisitions and developments to perform as expected;

- our ability to provide adequate management, maintenance and insurance;

- natural disasters, such as earthquakes, fires, hurricanes and floods, which could exceed the aggregate limits of our insurance coverage;

- the expense of periodically renovating, repairing and re-letting spaces;

- the impact of environmental protection laws;

- compliance with federal, state and local laws and regulations;

- increasing operating and maintenance costs, including property taxes, insurance and utilities, if these increased costs cannot be passed through to customers;
 - risks due to a potential November, 2020 statewide ballot initiative (or other equivalent actions) that could remove the protections of Proposition 13 with respect to our real estate and result in substantial increases in our assessed values and property tax bills in California;

- adverse changes in tax, real estate and zoning laws and regulations;

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- increasing competition from other commercial properties in our market;

- tenant defaults and bankruptcies;

- tenants' right to sublease space; and

- concentration of properties leased to non-rated private companies with uncertain financial strength.

There is significant competition among commercial property operators: Other commercial properties compete with our properties for tenants. Some of the competing properties may be newer and better located than our properties. Competition in the market areas in which many of our properties are located is significant and has affected our occupancy levels, rental rates and operating expenses. We also expect that new properties will be built in our markets. In addition, we compete with other buyers, some of which are larger than us, for attractive commercial properties. Therefore, we may not be able to grow as rapidly as we would like.

We may encounter significant delays and expense in re-letting vacant space, or we may not be able to re-let space at existing rates, in each case resulting in losses of income: When leases expire, we may incur expenses in retrofitting space and we may not be able to re-lease the space on the same terms. Certain leases provide customers with the right to terminate early if they pay a fee. As of December 31, 2018, 1,987 leases, representing 6.7 million, or 25.1%, of the leased square footage of our total portfolio, or 23.5% of annualized rental income, are scheduled to expire in 2019. While we have estimated our cost of renewing leases that expire in 2019, our estimates could be wrong. If we are unable to re-lease space promptly, if the terms are significantly less favorable than anticipated or if the costs are higher, our operating results, cash available for distribution or reinvestment and stock price could be negatively impacted.

Tenant defaults and bankruptcies may reduce our cash flow and distributions: We may have difficulty collecting from customers in default, particularly if they declare bankruptcy. Since many of our customers are non-rated private companies, this risk may be enhanced. There is inherent uncertainty in a customer's ability to continue paying rent if they are in bankruptcy. This could negatively affect our operating results, cash available for distribution or reinvestment and stock price.

Natural disasters or terrorist attacks could cause damage to our facilities that is not covered by insurance, and could increase costs, reduce revenues, and otherwise impair our operating results: While we maintain insurance coverage for the losses caused by earthquakes, fire or hurricanes, we could suffer uninsured losses or losses in excess of our insurance policy limits for such occurrences. Approximately 37.4% of our properties are located in California and are generally in areas that are subject to risks of earthquake-related damage. In the event of an earthquake, fire, hurricane or other natural disaster, we would remain liable on any mortgage debt or other unsatisfied obligations related to that property. In addition, we may not have sufficient insurance coverage for losses caused by a terrorist attack, or such insurance may not be available or cost-effective. Significant natural disasters, terrorist attacks, threats of future

terrorist attacks, or resulting wider armed conflict could have negative impacts on the U.S. economy, reducing demand for our rental space and impairing our operating results, even if our specific losses were covered. This could negatively affect our operating results, cash available for distribution or reinvestment and stock price.

The illiquidity of our real estate investments may prevent us from adjusting our portfolio to respond to market changes: There may be delays and difficulties in selling real estate. Therefore, we cannot easily change our portfolio when economic conditions change. In addition, when we sell properties at significant gains upon sale, it can increase our distribution requirements, thus making it difficult to retain and reinvest the sales proceeds. Also, REIT tax laws may impose negative consequences if we sell properties held for less than two years.

We may be adversely affected by changes in laws: Increases in income and service taxes may reduce our cash flow and ability to make expected distributions to our shareholders. Additionally, any changes in the tax law applicable to REITs may adversely affect taxation of us and/or our shareholders. Our properties are also subject to various federal, state and local regulatory requirements, such as state and local fire and safety codes. If we fail to comply with these requirements, governmental authorities could fine us or courts could award damages against us. We believe our properties comply with all significant legal requirements. However, these requirements could change in a way that could negatively affect our operating results, cash available for distribution or reinvestment and stock price.

We may incur significant environmental remediation costs: As an owner and operator of real properties, under various federal, state and local environmental laws, we are required to clean up spills or other releases of hazardous or toxic substances on or from our properties. Certain environmental laws impose liability whether or not the owner or buyer knew of, or was responsible for, the presence of the hazardous or toxic substances. In some cases, liability may not be limited to the value of the property. The presence of these substances, or the failure to properly remediate

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any resulting contamination, whether from environmental or microbial issues, also may adversely affect our ability to sell, lease, operate, or encumber our facilities.

We have conducted preliminary environmental assessments of most of our properties (and conduct these assessments in connection with property acquisitions) to evaluate the environmental condition of, and potential environmental liabilities associated with, our properties. These assessments generally consist of an investigation of environmental conditions at the property (including soil or groundwater sampling or analysis if appropriate), as well as a review of available information regarding the site and publicly available data regarding conditions at other sites in the vicinity. In connection with these property assessments, our operations and recent property acquisitions, we have become aware that prior operations or activities at some properties or from nearby locations have or may have resulted in contamination to the soil or groundwater at these properties. In circumstances where our environmental assessments disclose potential or actual contamination, we may attempt to obtain indemnifications and, in appropriate circumstances, we obtain limited environmental insurance in connection with the properties acquired, but we cannot assure you that such protections will be sufficient to cover actual future liabilities nor that our assessments have identified all such risks. Although we cannot provide any assurance, based on the preliminary environmental assessments, we are not aware of any environmental contamination of our facilities material to our overall business, financial condition or results of operations.

There has been an increasing number of claims and litigation against owners and managers of rental properties relating to moisture infiltration, which can result in mold or other property damage. When we receive a complaint concerning moisture infiltration, condensation or mold problems and/or become aware that an air quality concern exists, we implement corrective measures in accordance with guidelines and protocols we have developed with the assistance of outside experts. We seek to work proactively with our customers to resolve moisture infiltration and mold-related issues, subject to our contractual limitations on liability for such claims. However, we can give no assurance that material legal claims relating to moisture infiltration and the presence of, or exposure to, mold will not arise in the future.

Any such environmental remediation costs or issues, including any potential ongoing impacts on rent or operating expenses, could negatively impact our operating results, cash flow available for distribution or reinvestment and our stock price.

Operating costs, including property taxes, could increase: We could be subject to increases in insurance premiums, property and other taxes, repair and maintenance costs, payroll, utility costs, workers compensation, and other operating expenses due to various factors such as inflation, labor shortages, commodity and energy price increases, weather, changes to governmental safety and real estate use limitations, as well as other governmental actions. Our property tax expense, which totaled \$43.2 million during the year ended December 31, 2018, generally depends upon the assessed value of our real estate facilities as determined by assessors and government agencies, and accordingly could be subject to substantial increases if such agencies changed their valuation approaches or opinions or if new laws are enacted.

We have exposure to increased property tax in California: Approximately \$115.6 million of our 2018 net operating income is from our properties in California, and we incurred approximately \$14.0 million in related property tax expense. Due to the impact of Proposition 13, which generally limits increases in assessed values to 2% per year, the assessed value and resulting property tax we pay is significantly less than it would be if the properties were assessed at current values. From time to time proposals have been made to reduce the beneficial impact of Proposition 13, particularly with respect to commercial and industrial (non-residential) real estate. In late 2018, an initiative qualified for California's November 2020 statewide ballot that would create a "split roll," generally making Proposition 13's protections only applicable to residential real estate. We cannot predict whether the initiative will actually be on the ballot in 2020, or what the prospects for passage might be, or whether other changes to Proposition 13 may be proposed or adopted. If the initiative or a similar proposal were to be adopted, it would end the beneficial effect of Proposition 13 for our properties, and our property tax expense could increase substantially, adversely affecting our cash flow from operations and net income.

We must comply with the Americans with Disabilities Act, fire and safety regulations and zoning requirements, which can require significant expenditures: All of our properties must comply with the Americans with Disabilities Act and with related regulations (the "ADA"). The ADA has separate compliance requirements for "public accommodations" and "commercial facilities," but generally requires that buildings be made accessible to persons with disabilities. Various state laws impose similar requirements. A failure to comply with the ADA or similar state laws could lead to government imposed fines on us and/or litigation, which could also involve an award of damages to individuals affected by the non-compliance. In addition, we must operate our properties in compliance with numerous local fire and safety regulations, building codes, zoning requirements and other land use regulations, all of

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which are subject to change and could become more costly to comply with in the future. The cost of compliance with these requirements can be substantial, and could reduce cash otherwise available for distribution to shareholders. Failure to comply with these requirements could also affect the marketability and rentability of our real estate facilities.

We incur liability from customer and employment-related claims: From time to time we have to make monetary settlements or defend actions or arbitration to resolve customer or employment-related claims and disputes. Settling any such liabilities could negatively impact our earnings and cash available for distribution to shareholders, and could also adversely affect our ability to sell, lease, operate, or encumber affected facilities.

Our development of real estate can subject us to certain risks: As of December 31, 2018, we have a 95% interest in a 395-unit multifamily apartment complex with an aggregate cost of \$115.4 million, including the fair value of the land. We are also seeking entitlements for an additional multifamily development and are considering the potential redevelopment of other facilities in our portfolio. Development or redevelopment of facilities are subject to a number of risks, including construction delays, complications in obtaining necessary zoning, occupancy and other governmental permits, cost overruns, failures of our development partners, financing risks, and the possible inability to meet expected occupancy and rent levels. In addition, we do not have experience in multifamily development and are relying to some degree on the experience of our joint venture partner. As a result of these risks, our development projects may be worth less or may generate less revenue than we believed at the time of development. Any of the foregoing risks could negatively impact our operating results, cash flow available for distribution or reinvestment and our stock price. In addition, we may be unable to successfully integrate and effectively manage the properties we develop, which could adversely affect our results of operations.

Global economic conditions can adversely affect our business, financial condition, growth and access to capital.

Economic conditions in the areas we operate, capital markets, global economic conditions, and other events or factors could adversely affect rental demand for our real estate, our ability to grow our business and acquire new facilities, to access capital, as well as the value of our real estate. Such conditions, which could negatively impact our operating results, cash flow available for distribution or reinvestment and our stock price, include the following:

Commercial credit markets: Our results of operations and share price are sensitive to volatility in the credit markets. From time to time, the commercial real estate debt markets experience volatility as a result of various factors, including changing underwriting standards by lenders and credit rating agencies. This may result in lenders increasing the cost for debt financing, which could affect the economic viability of any acquisition or development activities we may undertake or otherwise increase our costs of borrowing. Conversely, to the extent that debt becomes cheaper or underwriting terms become more favorable, it could increase the overall amount of capital being invested in real estate, allowing more competitors to bid for facilities that we may wish to acquire, reducing the potential yield from acquisitions or preventing us from acquiring assets we might otherwise wish to acquire.

Capital markets: The issuance of perpetual preferred securities historically has been a significant source of capital to grow our business, and we have considered issuing unsecured debt publicly or in private transactions. We also consider issuance of our common equity a potential source of capital. Our ability to access these sources of capital can be adversely affected by challenging market conditions, which can increase the cost of issuance of preferred equity and debt, and reduce the value of our common shares, making such sources of capital less attractive or not feasible. We believe that we have sufficient working capital and capacity under our credit facilities and our retained cash flow from operations to continue to operate our business as usual and meet our current obligations. However, if we were unable to issue public equity or borrow at reasonable rates, that could limit the earnings growth that might otherwise result from the acquisition and development of real estate facilities.

Asset valuations: Market volatility makes the valuation of our properties difficult. There may be significant uncertainty in the valuation, or in the stability of the value, of our properties, which could result in a substantial decrease in the value of our properties. As a result, we may not be able to recover the carrying amount of our properties, which may require us to recognize an impairment charge in earnings. Reductions in the value of our assets could result in a reduction in the value of our common shares.

Potential negative impacts upon demand for our space and customers' ability to pay: We believe that our current and prospective customers are susceptible to global and local economic conditions as well as the impact of capital markets, asset valuations, and commercial credit markets, which could result in an impairment of our customers' existing business operations or curtail plans for growth. Such impairment could reduce demand for our rental space, or make it difficult for customers to fulfill their obligations to us under their leases.

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The acquisition of existing properties is a significant component of our long-term growth strategy, and acquisitions of existing properties are subject to risks that may adversely affect our growth and financial results.

We acquire existing properties, either in individual transactions or portfolios offered by other commercial real estate owners. In addition to the general risks related to real estate described above, we are also subject to the following risks associated with the acquisition of real estate facilities which could negatively impact our operating results, cash flow available for distribution or reinvestment and our stock price:

Due diligence could be insufficient: Failure to identify all significant circumstances or conditions that affect the value, rentability, or costs of operation of an acquired facility, such as unidentified structural, environmental, zoning, or marketability issues, could jeopardize realization of anticipated earnings from an acquisition and negatively impact our operating results.

We could fail to successfully integrate acquired properties into our platform: Failures to integrate acquired properties into our operating platform, such as a failure to maintain existing relationships with customers due to changes in processes, standards, customer service, could temporarily or permanently impair our operating results.

We compete with other real estate operators for facilities: We face significant competition for suitable acquisition properties from other real estate investors, including other publicly traded real estate investment trusts and private institutional investors. As a result, we may be unable to acquire additional properties we desire or the purchase price for desirable properties may be significantly increased, reducing potential yields from acquisitions.

Acquired properties are subject to property tax reappraisals, which occur following the acquisition and can be difficult to estimate: Facilities that we acquire are subject to property tax reappraisal, which can substantially increase ongoing property taxes. The reappraisal process is subject to a significant degree of uncertainty, because it involves the judgment of governmental agencies regarding real estate values and other factors. In connection with underwriting future or recent acquisitions of properties, if our estimates of property taxes following reappraisal are too low, we may not realize anticipated earnings from an acquisition.

We would incur adverse tax consequences if we fail to qualify as a REIT.

We believe that we have qualified as a REIT and intend to continue to maintain our REIT status. However, there can be no assurance that we qualify or will continue to qualify as a REIT, because of the highly technical nature of the REIT rules, the ongoing importance of factual determinations, the possibility of unidentified issues in prior periods or changes in our circumstances, as well as share ownership limits in our articles of incorporation that do not necessarily

ensure that our shareholder base is sufficiently diverse for us to qualify as a REIT. For any year we fail to qualify as a REIT, unless certain relief provisions apply, we would not be allowed a deduction for dividends paid, we would be subject to corporate tax on our taxable income, and generally we would not be allowed to elect REIT status until the fifth year after such a disqualification. Any taxes, interest, and penalties incurred would reduce our cash available for distributions to shareholders and could negatively affect our stock price. However, for years in which we failed to qualify as a REIT, we would not be subject to REIT rules which require us to distribute substantially all of our taxable income to our shareholders.

We may need to borrow funds to meet our REIT distribution requirements.

As a REIT, we must distribute substantially all of our “REIT taxable income” to our shareholders. Our income consists primarily of our share of our OP’s income. We intend to make sufficient distributions to qualify as a REIT and otherwise avoid corporate tax. However, differences in timing between income and expenses and the need to make nondeductible expenditures such as capital improvements and principal payments on debt could force us to borrow funds to make necessary shareholder distributions. Future dividend levels are not determinable at this time.

Changes in tax laws could negatively impact us.

The United States Treasury Department and Congress frequently review U.S. federal income tax legislation, regulations and other guidance. We cannot predict whether, when or to what extent new U.S. federal tax laws, regulations, interpretations or rulings will be adopted. Any legislative action may prospectively modify our tax treatment and, therefore, may adversely affect taxation of us or our shareholders.

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PS has significant influence over us.

As of December 31, 2018, PS owned 7.2 million shares of the Company's common stock and 7.3 million common units of the OP (100.0% of the common units not owned by the Company). Assuming issuance of the Company's common stock upon redemption of its partnership units, PS would own 41.7% (or 14.5 million shares) of the outstanding shares of the Company's common stock at December 31, 2018. In addition, the PS Business Parks name and logo are owned by PS and licensed to the Company under a non-exclusive, royalty-free license agreement. The license can be terminated by either party for any reason with six months written notice. Ronald L. Havner, Jr., the Company's chairman, is also Chairman of Trustees of PS. Joseph D. Russell, Jr. is a director and former Chief Executive Officer of the Company and also President and Chief Executive Officer of PS. Gary E. Pruitt, an independent director of the Company, is also a trustee of PS. Consequently, PS has the ability to significantly influence all matters submitted to a vote of our shareholders, including electing directors, changing our articles of incorporation, dissolving and approving other extraordinary transactions such as mergers, and all matters requiring the consent of the limited partners of the OP. PS's interest in such matters may differ from other shareholders. In addition, PS's ownership may make it more difficult for another party to take over or acquire our Company without PS's approval, even if favorable to our public shareholders.

Provisions in our organizational documents may prevent changes in control.

Our articles generally prohibit any person from owning more than 7% of our shares: Our articles of incorporation restrict the number of shares that may be owned by any "person," and the partnership agreement of our OP contains an anti-takeover provision. No shareholder (other than PS and certain other specified shareholders) may own more than 7% of the outstanding shares of our common stock, unless our Board of Directors of the Company (the "Board") waives this limitation. We imposed this limitation to avoid, to the extent possible, a concentration of ownership that might jeopardize our ability to qualify as a REIT. This limitation, however, also makes a change of control much more difficult (if not impossible). These provisions will prevent future takeover attempts not supported by PS even if a majority of our public shareholders consider it to be in their best interests, such as to receive a premium for their shares over market value or for other reasons.

Our Board can set the terms of certain securities without shareholder approval: Our Board is authorized, without shareholder approval, to issue up to 50.0 million shares of preferred stock and up to 100.0 million shares of equity stock, in each case in one or more series. Our Board has the right to set the terms of each of these series of stock. Consequently, the Board could set the terms of a series of stock that could make it difficult (if not impossible) for another party to take over our Company even if it might be favorable to our public shareholders. Our articles of incorporation also contain other provisions that could have the same effect. We can also cause our OP to issue additional interests for cash or in exchange for property.

The partnership agreement of our OP restricts our ability to enter into mergers: The partnership agreement of our OP generally provides that we may not merge or engage in a similar transaction unless either the limited partners of our OP are entitled to receive the same proportionate consideration as our shareholders, or 60% of the OP's limited partners approve the merger. In addition, we may not consummate a merger unless the matter is approved by a vote of

the OP's partners, with our interests in the OP voted in proportion to the manner in which our shareholders voted to approve the merger. These provisions have the effect of increasing PS's influence over us due to PS's ownership of operating partnership units. These provisions may make it more difficult for us to merge with another entity.

The interests of limited partners of our OP may conflict with the interests of our common stockholders.

Limited partners of our OP, including PS, have the right to vote on certain changes to the partnership agreement. They may vote in a way that is against the interests of our shareholders. Also, as general partner of our OP, we are required to protect the interests of the limited partners of the OP. The interests of the limited partners and of our shareholders may differ.

We depend on external sources of capital to grow our Company.

We are generally required under the Code to annually distribute at least 90% of our "REIT taxable income." Because of this distribution requirement, we may not be able to fund future capital needs, including any necessary building and tenant improvements, from operating cash flow. Consequently, we may need to rely on third-party sources of capital to fund our capital needs. We may not be able to obtain the financing on favorable terms or at all. Access to third-party sources of capital depends, in part, on general market conditions, the market's perception of our growth potential, our current and expected future earnings, our cash flow, and the market price per share of our

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common stock. If we cannot obtain capital from third-party sources, we may not be able to acquire properties when strategic opportunities exist, satisfy any debt service obligations, or make cash distributions to shareholders.

We are subject to laws and governmental regulations and actions that affect our operating results and financial condition.

Our business is subject to regulation under a wide variety of U.S. federal, state and local laws, regulations and policies including those applicable to our status as a REIT, and those imposed by the SEC, the Sarbanes-Oxley Act of 2002, the Dodd-Frank Wall Street Reform and Consumer Protection Act and the New York Stock Exchange (the "NYSE"), as well as applicable local, state and national labor laws. Although we have policies and procedures designed to comply with applicable laws and regulations, failure to comply with the various laws and regulations may result in civil and criminal liability, fines and penalties, increased costs of compliance and restatement of our financial statements and could also affect the marketability of our real estate facilities.

In response to current economic conditions or the current political environment or otherwise, laws and regulations could be implemented or changed in ways that adversely affect our operating results and financial condition, such as legislation that could otherwise increase operating costs. Such changes could also adversely affect the operations of our customers, which could affect the price and demand for our space as well as our customer's ability to pay their rent.

Holders of depositary shares, each representing 1/1,000 of a share of our outstanding preferred stock, have dividend, liquidation and other rights that are senior to the rights of the holders of shares of our common stock.

Holders of our shares of preferred stock are entitled to cumulative dividends before any dividends may be declared or set aside on our common stock. Upon liquidation, before any payment is made to holders of our common stock, shares of our preferred stock are entitled to receive a liquidation preference of \$25,000 per share (or \$25.00 per depositary share) plus any accrued and unpaid distributions before any payment is made to the common shareholders. These preferences may limit the amount received by our common shareholders for ongoing distributions or upon liquidation. In addition, our preferred stockholders have the right to elect two additional directors to our Board whenever dividends are in arrears in an aggregate amount equivalent to six or more quarterly dividends, whether or not consecutive.

Preferred Shareholders are subject to certain risks.

Holders of our preferred shares have preference rights over our common shareholders with respect to liquidation and distributions, which gives them some assurance of continued payment of their stated dividend rate, and receipt of their principal upon liquidation of the Company or redemption of their securities. However, holders of our preferred shares should consider the following risks:

- The Company has in the past, and could in the future, issue or assume additional debt. Preferred shareholders would be subordinated to the interest and principal payments of such debt, which would increase the risk that there would not be sufficient funds to pay distributions or liquidation amounts to the preferred shareholders.
- The Company has in the past, and could in the future, issue additional preferred shares that, while pari passu to the existing preferred shares, increases the risk that there would not be sufficient funds to pay distributions to the preferred shareholders.
- While the Company has no plans to do so, if the Company were to lose its REIT status or no longer elect REIT status, it would no longer be required to distribute its taxable income to maintain REIT status. If, in such a circumstance, the Company ceased paying dividends, unpaid distributions to the preferred shareholders would continue to accumulate. While the preferred shareholders would have the ability to elect two additional members to serve on our Board until the arrearage was cured. The preferred shareholders would not receive any compensation (such as interest) for the delay in the receipt of distributions, and it is possible that the arrearage could accumulate indefinitely.

Future issuances by us of shares of our common stock may be dilutive to existing stockholders, and future sales of shares of our common stock may adversely affect the market price of our common stock.

Sales of substantial amounts of shares of our common stock in the public market (either by us or by PS), or issuances of shares of common stock in connection with redemptions of common units of our OP, could adversely affect the market price of our common stock. The Company may seek to engage in common stock offerings in the

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future. Offerings of common stock, including by us in connection with portfolio or other property acquisitions or by PS in secondary offerings, and the issuance of common units of the OP in exchange for shares of common stock, could have an adverse effect on the market price of the shares of our common stock.

We rely on technology in our operations and failures, inadequacies or interruptions to our service could harm our business.

The execution of our business strategy is heavily dependent on the use of technologies and systems, including the Internet, to access, store, transmit, deliver and manage information and processes. We rely extensively on third-party vendors to retain data, process transactions and provide other systems services. The failure, damage or interruption of these systems, including as a result of power outages, computer and telecommunications failures, hackers, computer worms, viruses and other destructive or disruptive security breaches, natural disasters, terrorist attacks, and other catastrophic events could significantly and have a material adverse effect on our business.

If our confidential information is compromised or corrupted, including as a result of a cybersecurity breach, our reputation and business relationships could be damaged, which could adversely affect our financial condition and operating results.

In the ordinary course of our business we acquire and store sensitive data, including personally identifiable information of our prospective and current customers and our employees. The secure processing and maintenance of this information is critical to our operations and business strategy. Although we believe we have taken commercially reasonable steps to protect the security of our confidential information, information security risks have generally increased in recent years due to the rise in new technologies and the increased sophistication and activities of perpetrators of cyberattacks. Despite our security measures, our information technology and infrastructure could be vulnerable to a cyberattack or other data security breach which would penetrate our network security and our or our customers' or employees' confidential information could be compromised or misappropriated. Our confidential information may also be compromised due to programming or human error or malfeasance. Ever-evolving threats mean we must continually evaluate and adapt our systems and processes, and there is no guarantee that they will be adequate to safeguard against all data security breaches or misuses of data. In addition, as the regulatory environment related to information security, data collection and use, and privacy becomes increasingly rigorous, with new and changing requirements applicable to our business from multiple regulatory agencies at the local, state, federal, or international level, compliance with those requirements could also result in additional costs, or we could fail to comply with those requirements due to various reasons such as not being aware of them.

Any such access, disclosure or other loss of information could result in legal claims or proceedings, liability under laws that protect the privacy of personal information, regulatory penalties, disruption to our operations and the services we provide to customers or damage our reputation, any of which could adversely affect our results of operations, reputation and competitive position. In addition, our customers could lose confidence in our ability to protect their personal information, which could cause them to discontinue leasing our facilities. Such events could

lead to lost future revenues and adversely affect our results of operations and could result in remedial and other costs, fines or lawsuits, which could be in excess of any available insurance that we have procured.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

As of December 31, 2018, we owned 96 business parks consisting of a geographically diverse portfolio of 28.2 million rentable square feet of commercial real estate which consists of 17.5 million square feet of industrial space, 6.7 million square feet of flex space and 4.0 million square feet of office space. The weighted average occupancy rate for these assets throughout 2018 was 94.2% and the realized rent per square foot was \$15.34.

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The following table reflects the geographical diversification of the 96 business parks owned by the Company as of December 31, 2018, the type of the rentable square footage and the weighted average occupancy rates throughout 2018 (except as set forth below, all of the properties are held in fee simple interest) (in thousands, except number of business parks):

Region	Number of Business Parks	Rentable Square Footage				Total	Weighted Average Occupancy Rate
		Industrial	Flex	Office			
Northern California	29	6,391	514	340	7,245	97.8%	
Southern California	15	2,299	953	31	3,283	97.6%	
Dallas (1)	12	1,300	1,587	—	2,887	89.7%	
Austin	9	755	1,208	—	1,963	92.5%	
Northern Virginia	19	1,564	1,440	1,970	4,974	90.6%	
South Florida	3	3,728	126	12	3,866	96.4%	
Suburban Maryland	6	394	576	1,608	2,578	86.9%	
Seattle	3	1,092	270	28	1,390	98.2%	
Total	96	17,523	6,674	3,989	28,186	94.2%	

(1) The Company owns two properties comprised of 231,000 square feet that are subject to ground leases in Las Colinas, Texas. These leases expire in 2029 and 2030.

Along with the 28.2 million rentable square feet of commercial space, we also have a 95.0% interest in a 395-unit apartment complex.

We currently anticipate that each of our properties will continue to be used for its current purpose, other than the one property held for development. However, we will from time to time evaluate our properties from a highest and best use perspective, and may identify higher and better uses for its real estate. We renovate our properties in connection with the re-leasing of space to customers and expect to fund the costs of such renovations generally from rental income.

Competition exists in each of the market areas in which these properties are located, and we have risks that customers could default on leases and declare bankruptcy. We believe these risks are mitigated through the Company's geographic diversity and diverse customer base.

Please refer to “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations” for portfolio information with respect to lease expirations and operating results in 2018, 2017 and 2016 by region and by type of rentable space.

ITEM 3. LEGAL PROCEEDINGS

We are not presently subject to material litigation nor, to our knowledge, is any material litigation threatened against us, other than routine actions, claims and administrative proceedings arising in the ordinary course of business, some of which are expected to be covered by liability insurance or third party indemnifications and all of which collectively are not expected to have a materially adverse effect on our financial condition, results of operations, or liquidity.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

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PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market for the Registrant's Common Equity:

The common stock of the Company trades on the NYSE under the symbol PSB.

Holder:

As of February 18, 2019, there were 283 holders of record of the common stock.

Dividends:

Holders of common stock are entitled to receive distributions when and if declared by our Board out of any funds legally available for that purpose. As a REIT, we do not incur federal income tax if we distribute substantially all of our "REIT taxable income" each year, and if we meet certain organizational and operation rules. We believe we have met these REIT requirements in all periods presented herein, and we expect to continue to elect and qualify as a REIT.

The Board has established a distribution policy intended to maximize the retention of operating cash flow and distribute the amount required for the Company to maintain its tax status as a REIT.

Issuer Repurchases of Equity Securities:

The Board previously authorized the repurchase, from time to time, of up to 6.5 million shares of the Company's common stock on the open market or in privately negotiated transactions. During the three months ended December 31, 2018, there were no shares of the Company's common stock repurchased. As of December 31, 2018, the Company has 1,614,721 shares available for repurchase under the program. The program does not expire. Purchases will be

made subject to market conditions and other investment opportunities available to the Company.

Securities Authorized for Issuance Under Equity Compensation Plans:

The equity compensation plan information is provided in Item 12, “Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.”

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ITEM 6. SELECTED FINANCIAL DATA

The following tables set forth selected consolidated financial and operating information on a historical basis of the Company. The following information should be read in conjunction with the consolidated financial statements and notes thereto of the Company included in this Form 10-K.

	For The Years Ended December 31,				
	2018	2017	2016	2015	2014
	(In thousands, except per share data)				
Rental income	\$ 413,516	\$ 402,179	\$ 386,871	\$ 373,135	\$ 376,255
Expenses					
Cost of operations	126,547	125,340	123,108	121,224	127,371
Depreciation and amortization	99,242	94,270	99,486	105,394	110,357
General and administrative	10,155	9,679	14,862	13,582	13,639
Total operating expenses	235,944	229,289	237,456	240,200	251,367
Interest and other income	1,510	942	1,233	1,130	1,032
Interest and other expense	(665)	(1,285)	(5,664)	(13,330)	(13,593)
Equity in loss of unconsolidated joint venture	—	(805)	—	—	—
Gain on sale of real estate facilities	93,484	1,209	—	28,235	92,373
Gain on sale of development rights	—	6,365	—	—	—
Net income	271,901	179,316	144,984	148,970	204,700
Allocation to noncontrolling interests	(45,199)	(24,279)	(16,955)	(18,495)	(30,729)
Net income allocable to PS Business Parks, Inc.	226,702	155,037	128,029	130,475	173,971
Allocation to preferred shareholders based upon					
Distributions	(51,880)	(52,873)	(57,276)	(59,398)	(60,488)
Redemptions	—	(10,978)	(7,312)	(2,487)	—
Allocation to restricted stock unit holders	(1,923)	(761)	(569)	(299)	(329)
Net income allocable to common shareholders	\$ 172,899	\$ 90,425	\$ 62,872	\$ 68,291	\$ 113,154
Per Common Share:					
Cash Distributions (1)	\$ 3.80	\$ 3.40	\$ 3.00	\$ 2.20	\$ 4.75
Net income — basic	\$ 6.33	\$ 3.32	\$ 2.32	\$ 2.53	\$ 4.21
Net income — diluted	\$ 6.31	\$ 3.30	\$ 2.31	\$ 2.52	\$ 4.19
Weighted average common shares — basic	27,321	27,207	27,089	26,973	26,899
Weighted average common shares — diluted	27,422	27,412	27,179	27,051	27,000

(1) Amount includes a \$2.75 per common share special cash dividend for the year ended December 31, 2014.

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	As Of And For The Years Ended December 31,				
	2018	2017	2016	2015	2014
	(In thousands, except per square foot data)				
Balance Sheet Data					
Total assets	\$ 2,068,594	\$ 2,100,159	\$ 2,119,371	\$ 2,186,658	\$ 2,227,114
Total debt	\$ —	\$ —	\$ —	\$ 250,000	\$ 250,000
Preferred stock called for redemption	\$ —	\$ 130,000	\$ 230,000	\$ —	\$ —
Equity					
PS Business Parks, Inc.'s shareholders' equity					
Preferred stock	\$ 959,750	\$ 959,750	\$ 879,750	\$ 920,000	\$ 995,000
Common stock	\$ 805,612	\$ 733,561	\$ 733,509	\$ 740,496	\$ 718,281
Noncontrolling interests	\$ 218,091	\$ 196,625	\$ 197,455	\$ 200,103	\$ 194,928
Other Data					
Net cash provided by operating activities	\$ 276,153	\$ 271,614	\$ 250,507	\$ 238,839	\$ 228,180
Net cash (used in) provided by investing activities	\$ (36,066)	\$ (79,237)	\$ (85,008)	\$ 3,131	\$ 113,188
Net cash used in financing activities	\$ (317,590)	\$ (205,036)	\$ (225,782)	\$ (205,525)	\$ (220,382)
Square footage owned at the end of period	28,186	28,028	28,072	27,969	28,550
Weighted average occupancy rate (1)	94.2%	93.8%	94.0%	92.8%	91.3%
Revenue per occupied square foot (1) (2)	\$ 15.34	\$ 15.30	\$ 14.61	\$ 14.27	\$ 14.00

(1) Weighted average occupancy and revenue per occupied square foot of our total portfolio for each of the last five years, including assets sold and held for sale. The amounts shown in 2018 exclude the assets sold during the year.

(2) Excludes material lease buyout payments of \$528,000 for the year ended December 31, 2016.

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of the results of operations and financial condition should be read in conjunction with the selected financial data and the Company's consolidated financial statements and notes thereto included in this Form 10-K.

Critical Accounting Policies and Estimates:

Our accounting policies are described in Note 2 to the consolidated financial statements included in this Form 10-K. We believe our critical accounting policies relate to income tax expense, accounting for acquired real estate facilities, allowance for doubtful accounts, impairment of long-lived assets, and accrual for uncertain and contingent liabilities, each of which are more fully discussed below.

Income Tax Expense: We have elected to be treated as a REIT, as defined in the Code. As a REIT, we do not incur federal income tax on our "REIT taxable income" that is fully distributed each year (for this purpose, certain distributions paid in a subsequent year may be considered), and if we meet certain organizational and operational rules. We believe we have met these REIT requirements for all periods presented herein. Accordingly, we have recorded no federal income tax expense related to our "REIT taxable income."

Our evaluation that we have met the REIT requirements could be incorrect, because compliance with the tax rules requires factual determinations, and circumstances we have not identified could result in noncompliance with the tax requirements in current or prior years. For any taxable year that we fail to qualify as a REIT and for which applicable statutory relief provisions did not apply, we would be taxed at the regular corporate rates on all of our taxable income for at least that year and the ensuing four years, we could be subject to penalties and interest, and our net income would be materially different from the amounts shown in our consolidated financial statements.

Accounting for Acquired Real Estate Facilities: We estimate the fair values of the land, buildings, intangible assets and intangible liabilities for purposes of allocating purchase price. Such estimates are based upon many assumptions and judgments, including (i) market rates of return and capitalization rates on real estate and intangible assets, (ii) building and material cost levels, (iii) comparisons of the acquired underlying land parcels to recent land transactions, (iv) estimated market rent levels and (v) future cash flows from the real estate and the existing customer base. Others could come to materially different conclusions as to the estimated fair values, which would result in different depreciation and amortization expense, rental income, gains and losses on sale of real estate assets, and real estate and intangible assets.

Allowance for Doubtful Accounts: Customer receivables consist primarily of amounts due for contractual lease payments, reimbursements of common area maintenance expenses, property taxes and other expenses recoverable from customers. Deferred rent receivable represents the amount that the cumulative straight-line rental income recorded to date exceeds cash rents billed to date under the lease agreement. Determination of the adequacy of allowances for doubtful accounts requires significant judgments and estimates. Others could come to materially different conclusions regarding the adequacy of our allowance for doubtful accounts. Significant unreserved bad debt losses could materially impact our net income.

Impairment of Long-Lived Assets: The analysis of impairment of our long-lived assets involves identification of indicators of impairment, projections of future operating cash flows and estimates of fair values or selling prices, all of which require significant judgment and subjectivity. Others could come to materially different conclusions. In addition, we may not have identified all current facts and circumstances that may affect impairment. Any unidentified impairment loss, or change in conclusions, could have a material adverse impact on our net income.

Accrual for Uncertain and Contingent Liabilities: We accrue for certain contingent and other liabilities that have significant uncertain elements, such as property taxes, performance bonuses and other operating expenses, as well as other legal claims and disputes involving customers, employees, governmental agencies and other third parties. We estimate such liabilities based upon many factors such as past trends and our evaluation of likely outcomes. However, the estimates of known liabilities could be incorrect or we may not be aware of all such liabilities, in which case our accrued liabilities and net income could be materially different.

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Business Overview

Our overall operating results are impacted primarily by the performance of our existing real estate facilities, which at December 31, 2018 are comprised of 28.2 million rentable square feet of primarily multi-tenant industrial, flex and office properties concentrated in six states and a 95.0% interest in a 395-unit multifamily apartment complex. Our multi-tenant commercial properties are located in markets that have experienced long-term economic growth with a particular concentration on small- and medium-size customers. Accordingly, a significant degree of management attention is paid to maximizing the cash flow from our existing real estate portfolio. Also, our strong and conservative capital structure allows us the flexibility to use debt and equity capital prudently to fund our growth, which allows us to acquire properties we believe will create long-term value. From time to time we sell properties which no longer fit the Company's strategic objectives.

At January 1, 2018, we reclassified 7.6 million rentable square feet from "flex" space, as presented in our December 31, 2017 annual report, to "industrial" space based upon a thorough review of our properties' office to warehouse ratio. We believe the reclassification will assist investors to better understand our business operations.

Existing Real Estate Facilities: The operating results of our existing real estate facilities are substantially influenced by demand for rental space within our properties and our markets, which impacts occupancy, rental rates and capital expenditure requirements. We strive to maintain high occupancy levels while increasing rental rates and minimizing capital expenditures when market conditions allow, although the Company may decrease rental rates in markets where conditions require. Management's initiatives and strategies with respect to our existing real estate facilities include incentivizing our personnel to maximize the return on investment for each lease transaction and providing a superior level of service to our customers.

Acquisitions of Real Estate Facilities: We also seek to grow our operations through acquisitions of facilities generally consistent with the Company's focus on owning concentrated business parks with easily configurable space and in markets and product types with favorable long-term return potential. On June 8, 2018, we acquired two multi-tenant industrial parks aggregating 1.1 million rentable square feet in Springfield, Virginia, for a net purchase price of \$143.8 million. The portfolio consists of 19 buildings and was 76.1% occupied as of the date of acquisition. The 19 buildings are located in the Springfield/Newington industrial submarket where we already own three industrial parks totaling 606,000 square feet. We continue to seek to acquire additional facilities in our existing markets and generally in close proximity to our existing facilities; however, there can be no assurance that we will acquire additional facilities that meet our risk-adjusted return and underwriting requirements.

Development or redevelopment of real estate facilities: We also may seek to redevelop our existing real estate. We own a large contiguous block of real estate (628,000 rentable square feet on 44.5 acres of land) located within an area known as The Mile in Tysons, Virginia. We demolished one of our existing office buildings at The Mile and built Highgate at a cost, including the estimated fair value of existing land, of \$115.4 million.

While multifamily real estate is not a core asset class for us, we determined that multifamily real estate represented a unique opportunity and the highest and best use of that parcel. We have partnered through a joint venture with a local developer and operator of multifamily space in order to leverage their operational experience. See “Analysis of Net Income – Multifamily”, “Analysis of Net Income – Equity in loss of unconsolidated joint venture” below and Notes 3 and 4 to our consolidated financial statements for more information on Highgate.

We commenced consolidating Highgate beginning January 1, 2018. Prior to January 1, 2018, we accounted for our investment in the joint venture using the equity method and accordingly, reflected our share of net loss under “equity in loss of unconsolidated joint venture.”

We have an additional 123,000 square foot vacant office building located within The Mile that we are seeking to demolish in order to construct another multifamily property on the parcel. This parcel is reflected on our consolidated balance sheets as land and building held for development. The scope and timing of development of this site is subject to a variety of contingencies, including approval of entitlements. We do not expect that development will commence any earlier than the first quarter of 2020.

Sales of Real Estate Facilities: We may from time to time sell individual real estate facilities based on market conditions, fit with our existing portfolio, evaluation of long-term potential returns of markets or product types, or other reasons.

On March 5, 2018, we sold Corporate Pointe Business Park, a park consisting of five multi-tenant office buildings totaling 161,000 square feet, located in Orange County, California, for net sale proceeds of \$41.7 million, which

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resulted in a gain of \$26.8 million. On April 18, 2018, we sold Orange County Business Center, a park consisting of five multi-tenant office buildings totaling 437,000 square feet located in Orange County, California, for net sale proceeds of \$73.3 million, which resulted in a gain of \$50.6 million. On April 30, 2018, we sold Northgate Business Park, a park consisting of seven multi-tenant flex buildings totaling 194,000 square feet located in Dallas, Texas, for net sale proceeds of \$11.8 million, which resulted in a gain of \$7.9 million. On October 31, 2018, we sold Orangewood Office Park, a park consisting of two multi-tenant office buildings totaling 107,000 square feet located in Orange County, California, for net sale proceeds of \$18.3 million, which resulted in a gain of \$8.2 million.

On May 1, 2017, we sold Empire Commerce, a two-building single-story office park comprising 44,000 square feet, located in Dallas, Texas, for net sale proceeds of \$2.1 million, which resulted in a net gain of \$1.2 million.

The operations of the facilities we sold are presented below under “assets sold or held for development.”

Certain Factors that May Impact Future Results

Impact of Inflation: Although inflation has not been significant in recent years, an increase in inflation could impact our future results, and the Company continues to seek ways to mitigate its potential impact. A substantial portion of the Company’s leases require customers to pay operating expenses, including real estate taxes, utilities and insurance, as well as increases in common area expenses, partially reducing the Company’s exposure to inflation during each lease’s respective lease period.

Regional Concentration: Our portfolio is concentrated in eight regions, in six states. We have chosen to concentrate in these regions because we believe they have characteristics which enable them to be competitive economically, such as above average population growth, job growth, higher education levels and personal income, which we believe will produce better overall economic returns. Changes in economic conditions in these regions in the future could impact our future results.

Industry and Customer Concentrations: We seek to minimize the risk of industry or customer concentrations. As of December 31, 2018, industry groups that represented more than 10% of our annual rental income were business services, warehouse, distribution, transportation and logistics, computer hardware, software and related services and health services. No other industry group represents more than 10% of our annualized rental income as depicted in the following table.

Percent of
Annualized

Industry	Rental Income
Business services	19.3%
Warehouse, distribution, transportation and logistics	11.4%
Computer hardware, software and related services	10.6%
Health services	10.1%
Retail, food, and automotive	7.7%
Engineering and construction	7.3%
Government	7.0%
Insurance and financial services	3.6%
Electronics	3.1%
Home furnishings	2.6%
Communications	1.9%
Aerospace/defense products and services	1.9%
Educational services	1.1%
Other	12.4%
Total	100.0%

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As of December 31, 2018, leases from our top 10 customers comprised 9.4% of our annualized rental income, with only one customer, the U.S. Government (4.0%), representing more than 1% as depicted in the following table (in thousands).

Customers	Square Footage	Annualized Rental Income (1)	Percent of Annualized Rental Income
U.S. Government	681	\$ 16,656	4.0%
Luminex Corporation	199	3,949	1.0%
Keeco, L.L.C.	460	2,870	0.7%
Lockheed Martin Corporation	143	2,670	0.6%
CEVA Logistics U.S., Inc.	213	2,340	0.6%
KZ Kitchen Cabinet & Stone	191	2,310	0.6%
Applied Materials, Inc.	162	2,236	0.5%
Carbel, LLC	207	2,054	0.5%
Investorplace Media, LLC	46	1,925	0.5%
Raytheon	78	1,720	0.4%
Total	2,380	\$ 38,730	9.4%

(1) For leases expiring prior to December 31, 2019, annualized rental income represents income to be received under existing leases from January 1, 2019 through the date of expiration.

Customer credit risk: We have historically experienced a low level of write-offs of uncollectible rents, with less than 0.5% of rental income written off in any year over the last seven years. However, there can be no assurance that write offs may not increase, because there is inherent uncertainty in a customer's ability to continue paying rent and meet its full lease obligation. As of February 18, 2019, we had 158,000 square feet of leased space occupied by five customers that are protected by Chapter 11 of the U.S. Bankruptcy Code. From time to time, customers contact us, requesting early termination of their lease, reductions in space leased, or rent deferment or abatement, which we are not obligated to grant but will consider under certain circumstances.

Net Operating Income

We evaluate the performance of our business parks primarily based on net operating income ("NOI"), a measure that is not defined in accordance with U.S. generally accepted accounting principles ("GAAP"). We define NOI as adjusted rental income less adjusted cost of operations. Adjusted rental income represents rental income, excluding material lease buyout payments, which we believe are not reflective of ongoing rental income. Adjusted cost of operations

represents cost of operations, excluding Senior Management Long-Term Equity Incentive Plan (“LTEIP”) amortization, which can vary significantly period to period based upon the performance of the whole company, rather than just property operations.

We believe NOI assists investors in analyzing the performance and value of our business parks by excluding (i) corporate items not related to the results of our business parks, (ii) depreciation and amortization expense because it does not accurately reflect changes in the value of our business parks and (iii) material lease buyout payments and LTEIP amortization as these items significantly vary from period to period and thus impact comparability across periods. The Company’s calculation of NOI may not be comparable to those of other companies and should not be used as an alternative to performance measures calculated in accordance with GAAP.

See “Analysis of net income” below for reconciliations of each of these measures to their closest analogous GAAP measure from our consolidated statements of income.

Results of Operations

Operating Results for 2018 and 2017

For the year ended December 31, 2018, net income allocable to common shareholders was \$172.9 million or \$6.31 per diluted share, compared to \$90.4 million or \$3.30 per diluted share for the year ended December 31, 2017. The increase was mainly due to the gain on the sale of three office parks in Orange County, California, and an industrial park in Dallas, Texas, during 2018, charges related to the redemption of preferred stock incurred in 2017 that did not recur in 2018 and an increase in NOI of \$9.1 million with respect to our real estate facilities. The increase in NOI includes a \$7.1 million increase from our Same-Park facilities (defined below) due primarily to increased occupancy

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and higher revenue per occupied square foot combined with increased NOI from our non-Same Park and multifamily assets, partially offset by reduced NOI generated from facilities we sold in 2018.

Operating Results for 2017 and 2016

For the year ended December 31, 2017, net income allocable to common shareholders was \$90.4 million or \$3.30 per diluted share, compared to \$62.9 million or \$2.31 per diluted share for the year ended December 31, 2016. The increase was due to a \$12.9 million increase in NOI with respect to our real estate facilities, the gain on the sale of the real estate facilities and development rights, a reduction in preferred distributions and a reduction in interest expense due to the repayment of debt, partially offset by an increase in charges related to the redemption of preferred securities. The increase in NOI includes a \$14.2 million increase from our Same-Park facilities due primarily to higher revenue per occupied square foot and increased occupancy, offset partially by reduced NOI with respect to facilities we sold or held for development.

Analysis of Net Income

Our net income is comprised primarily of our real estate operations, depreciation and amortization expense, general and administrative expenses, interest and other income, interest and other expenses and gain on sale of real estate facilities and development rights.

We segregate our real estate activities into (a) same park operations, representing all operating properties acquired prior to January 1, 2016, comprising 26.9 million rentable square feet of our 28.2 million total rentable square feet at December 31, 2018 (the "Same Park" facilities), (b) non-same park operations, representing those facilities we own that were acquired after January 1, 2016 (the "Non-Same Park" facilities), (c) multifamily operations and (d) assets sold or held development, representing facilities whose existing operations are no longer part of our ongoing operations, because they were sold or developed or converted to alternate use.

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The table below sets forth the various components of our net income (in thousands):

	For the Years Ended December 31,			For the Years Ended December 31,		
	2018	2017	Variance	2017	2016	Variance
Rental income						
Adjusted rental income (1)						
Same Park	\$ 392,149	\$ 384,504	\$ 7,645	\$ 384,504	\$ 367,663	\$ 16,841
Non-Same Park	8,680	1,495	7,185	1,495	296	1,199
Multifamily	7,353	—	7,353	—	—	—
Assets sold or held for development (2)	5,334	16,180	(10,846)	16,180	18,384	(2,204)
Lease buyout payment	—	—	—	—	528	(528)
Total rental income	413,516	402,179	11,337	402,179	386,871	15,308
Cost of operations						
Adjusted cost of operations (3)						
Same Park	115,602	115,055	547	115,055	112,399	2,656
Non-Same Park	3,355	1,373	1,982	1,373	289	1,084
Multifamily	4,054	—	4,054	—	—	—
Assets sold or held for development (2)	2,268	6,581	(4,313)	6,581	7,417	(836)
LTEIP amortization	1,268	2,331	(1,063)	2,331	3,003	(672)
Total cost of operations	126,547	125,340	1,207	125,340	123,108	2,232
Net operating income (4)						
Same Park	276,547	269,449	7,098	269,449	255,264	14,185
Non-Same Park	5,325	122	5,203	122	7	115
Multifamily	3,299	—	3,299	—	—	—
Assets sold or held for development (2)	3,066	9,599	(6,533)	9,599	10,967	(1,368)
Lease buyout payment	—	—	—	—	528	(528)
LTEIP amortization	(1,268)	(2,331)	1,063	(2,331)	(3,003)	672
Depreciation and amortization expense	(99,242)	(94,270)	(4,972)	(94,270)	(99,486)	5,216
General and administrative expense	(10,155)	(9,679)	(476)	(9,679)	(14,862)	5,183
Interest and other income	1,510	942	568	942	1,233	(291)
Interest and other expense	(665)	(1,285)	620	(1,285)	(5,664)	4,379
Equity in loss of unconsolidated joint venture	—	(805)	805	(805)	—	(805)
Gain on sale of real estate facilities	93,484	1,209	92,275	1,209	—	1,209
Gain on sale of development rights	—	6,365	(6,365)	6,365	—	6,365
Net income	\$ 271,901	\$ 179,316	\$ 92,585	\$ 179,316	\$ 144,984	\$ 34,332

(1) Adjusted rental income excludes material lease buyout payments.

(2)

The operations for “assets sold or held for development” are primarily comprised of the historical operations, for all periods shown, of the 705,000 rentable square feet of office product and 194,000 rentable square feet of flex product sold in 2018. For the year ended December 31, 2017, “assets sold or held for development” includes historical operations of 44,000 square feet of assets sold during 2017. For the year ended December 31, 2016, “assets sold or held for development” also includes historical operations from a 123,000 square foot office building held for development.

- (3) Adjusted cost of operations excludes the impact of LTEIP amortization.
- (4) Net operating income represents adjusted rental income less adjusted cost of operations.

Rental income increased \$11.3 million in 2018 compared to 2017 and by \$15.3 million in 2017 as compared to 2016 due primarily to increases in adjusted rental income at the Same Park and Non-Same Park facilities, offset partially by adjusted rental income from assets sold or held for development. The 2018 increase was also attributable to rental income from our multifamily asset. The increases in adjusted rental income at the Same Park facilities in 2018 and 2017 were due primarily to higher revenue per occupied square foot and increased occupancy.

Cost of operations increased \$1.2 million in 2018 compared to 2017 and by \$2.2 million in 2017 as compared to 2016 due primarily to increases in adjusted cost of operations for the Same Park and Non-Same Park facilities, offset partially by adjusted costs of operations from assets sold or held for development. The 2018 increase was also attributed to cost of operations from our multifamily asset. The 2018 and 2017 increases in cost of operations was partially offset by lower LTEIP amortization.

Net income increased \$92.6 million in 2018 compared to 2017 and by \$34.3 million in 2017 compared to 2016. The 2018 increase in net income was primarily due to the gain on the sale of three office parks in Orange County,

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California, and an industrial park in Dallas, Texas, during 2018 combined with higher rental income partially offset by higher depreciation and amortization expense. The 2017 increase was due primarily to higher rental income combined with gain on the sale of the real estate facilities and development rights, lower depreciation and amortization expense, lower general and administrative expenses and a reduction in interest expense.

Same Park Facilities

The Same Park facilities are those that we have owned and operated since January 1, 2016. We evaluate the operations of these facilities to provide an informative view of how the Company's portfolio has performed over comparable periods. We believe that Same Park information is used by investors and analysts in a similar manner. The following table summarizes the historical operating results of these facilities and certain statistical information related to leasing activity in 2018, 2017 and 2016 (in thousands, except per square foot data):

	For the Years Ended December 31,			For the Years Ended December 31,		
	2018	2017	Variance	2017	2016	Variance
Adjusted rental income	\$ 392,149	\$ 384,504	2.0%	\$ 384,504	\$ 367,663	4.6%
Adjusted cost of operations						
Property taxes	40,175	39,279	2.3%	39,279	38,177	2.9%
Utilities	22,437	21,934	2.3%	21,934	22,026	(0.4%)
Repairs and maintenance	24,569	25,832	(4.9%)	25,832	23,414	10.3%
Snow removal	910	544	67.3%	544	1,810	(69.9%)
Other expenses	27,511	27,466	0.2%	27,466	26,972	1.8%
Total	115,602	115,055	0.5%	115,055	112,399	2.4%
NOI	\$ 276,547	\$ 269,449	2.6%	\$ 269,449	\$ 255,264	5.6%
Selected Statistical Data						
NOI margin (1)	70.5%	70.1%	0.6%	70.1%	69.4%	1.0%
Weighted average square foot occupancy	94.9%	94.4%	0.5%	94.4%	94.3%	0.1%
Revenue per occupied square foot (2)	\$ 15.36	\$ 15.15	1.4%	\$ 15.15	\$ 14.50	4.5%

(1) NOI margin is computed by dividing NOI by adjusted rental income.

(2) Revenue per occupied square foot is computed by dividing adjusted rental income during the period by weighted average occupied square feet during the same period.

Analysis of Same Park Adjusted Rental Income

Adjusted rental income generated by the Same Park facilities increased 2.0% in 2018 as compared to 2017 and by 4.6% in 2017 as compared to 2016. These increases were due primarily to higher rental rates charged to our customers, as revenue per occupied square foot increased 1.4% and 4.5% in 2018 and 2017, respectively, compared to the year prior. Weighted average occupancy increased 0.5% and 0.1% in 2018 and 2017, respectively, compared to the year prior.

We believe that high occupancies help maximize our rental income. Accordingly, we seek to maintain a weighted average occupancy over 90%.

During 2018 and 2017, most markets continued to reflect favorable conditions allowing for stable occupancy as well as increasing rental rates. With the exception of Northern Virginia and Suburban Maryland markets, new rental rates for the Company improved over expiring rental rates on executed leases as economic conditions and tenant demand remained robust.

Our future revenue growth will come primarily from potential increases in market rents allowing us to increase rent levels when leases are either renewed with existing customers or re-leased to new customers. The following table sets forth the expirations of existing leases in our Same Park portfolio over the next 10 years based on lease data at December 31, 2018 (dollars and square feet in thousands):

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Year of Lease Expiration	Number of Customers	Rentable Square Footage Subject to Expiring Leases	Percent of Total Leased Square Footage	Annualized Rental Income Under Expiring Leases	Percent of Annualized Rental Income Represented by Expiring Leases
2019	1,955	6,534	25.4%	\$ 101,304	23.8%
2020	1,480	6,084	23.7%	94,857	22.2%
2021	701	3,895	15.1%	64,006	15.0%
2022	313	3,437	13.4%	60,759	14.3%
2023	297	2,630	10.2%	44,439	10.4%
2024	56	1,220	4.7%	20,566	4.8%
2025	37	1,084	4.2%	21,803	5.1%
2026	16	245	1.0%	5,332	1.3%
2027	6	24	0.1%	962	0.2%
2028	9	309	1.2%	5,935	1.4%
Thereafter	9	252	1.0%	6,521	1.5%
Total	4,879	25,714	100.0%	\$ 426,484	100.0%

During the year ended December 31, 2018, we leased 7.2 million in rentable square feet to new and existing customers, with an average increase in rental rates over the previous rates of 5.1%. Renewals of leases with existing customers represented 63.3% of our leasing activity for the year ended December 31, 2018. See “Analysis of Same Park Market Trends” below for further analysis of such data on a by-market basis.

Our ability to re-lease space on expired leases in a way that minimizes vacancy periods and achieves market rental rates will depend upon market conditions in the specific submarkets in which each of our properties are located.

Analysis of Same Park Adjusted Cost of Operations

Adjusted costs of operations generated by the Same Park facilities increased 0.5% in 2018 as compared to 2017 due primarily to increased property taxes, higher utility costs and snow removal costs, partially offset by lower repairs and maintenance expense. Adjusted costs of operations increased by 2.4% in 2017 as compared to 2016 due primarily to increased repairs and maintenance expense and property taxes partially offset by reduced snow removal costs.

Property taxes increased 2.3% in 2018 as compared to 2017 and by 2.9% in 2017 as compared to 2016 due primarily to higher assessed values. We expect property tax growth in the future due primarily to higher assessed values and

changes in tax rates.

Utilities are dependent primarily upon energy prices and usage levels. Changes in usage levels are driven primarily by weather and temperature. Utilities increased 2.3% in 2018 as compared to 2017 and decreased 0.4% in 2017 as compared to 2016. It is difficult to estimate future utility costs, because weather, temperature and energy prices are volatile and not predictable. However, based upon current trends and expectations regarding commercial electricity rates, we expect inflationary increases in rates in the future.

Repairs and maintenance decreased 4.9% in 2018 as compared to 2017 due to incremental costs in 2017 relating to Hurricane Irma and increased by 10.3% in 2017 as compared to 2016 for the same reason. Repairs and maintenance costs are dependent upon many factors including weather conditions, which can impact repair and maintenance needs, inflation in material and labor costs and random events, and as a result are not readily predictable.

Snow removal increased 67.3% in 2018 as compared to 2017 and decreased by 69.9% in 2017 as compared to 2016. Snow removal costs are weather dependent and therefore not predictable.

Other expenses increased 0.2% in 2018 as compared to 2017 and 1.8% in 2017 as compared to 2016. These costs are comprised of on site and supervisory personnel, property insurance and other expenses incurred in the operation of our properties. We expect increases in other expenses to be similar to the increases in prior years.

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Same Park Quarterly Trends

The following table sets forth historical quarterly data in the operations of the Same Park facilities for adjusted rental income, adjusted cost of operations, occupancies, and annualized revenue per occupied square foot (in thousands, except per square foot data):

	For the Three Months Ended				Full Year
	March 31	June 30	September 30	December 31	
Adjusted rental income					
2018	\$ 98,022	\$ 97,760	\$ 98,228	\$ 98,139	\$ 392,149
2017	\$ 95,756	\$ 95,464	\$ 96,073	\$ 97,211	\$ 384,504
2016	\$ 91,341	\$ 91,617	\$ 92,103	\$ 92,602	\$ 367,663
Adjusted cost of operations					
2018	\$ 30,035	\$ 28,865	\$ 28,817	\$ 27,885	\$ 115,602
2017	\$ 28,214	\$ 28,008	\$ 29,191	\$ 29,642	\$ 115,055
2016	\$ 29,384	\$ 27,086	\$ 28,211	\$ 27,718	\$ 112,399
Weighted average square foot occupancy					
2018	94.6%	94.6%	95.0%	95.2%	94.9%
2017	94.6%	93.7%	94.1%	95.1%	94.4%
2016	94.3%	93.8%	94.2%	94.8%	94.3%
Annualized revenue per occupied square foot					
2018	\$ 15.40	\$ 15.36	\$ 15.36	\$ 15.32	\$ 15.36
2017	\$ 15.05	\$ 15.15	\$ 15.18	\$ 15.20	\$ 15.15
2016	\$ 14.40	\$ 14.52	\$ 14.54	\$ 14.53	\$ 14.50

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Analysis of Same Park Market Trends

The following tables set forth adjusted rental income, adjusted cost of operations, occupancy data and revenue per occupied square foot by period in our Same Park facilities (in thousands, except per square foot data):

Region	For the Years Ended December 31,			For the Years Ended December 31,		
	2018	2017	Variance	2017	2016	Variance
Selected Geographic Data on Same Park						
Adjusted rental income						
Northern California (7.2 million feet)	\$ 99,610	\$ 93,032	7.1%	\$ 93,032	\$ 86,395	7.7%
Southern California (3.3 million feet)	52,873	50,269	5.2%	50,269	47,583	5.6%
Dallas (2.9 million feet)	30,899	31,398	(1.6%)	31,398	29,896	5.0%
Austin (2.0 million feet)	29,608	29,240	1.3%	29,240	27,467	6.5%
Northern Virginia (3.9 million feet)	73,818	75,590	(2.3%)	75,590	76,285	(0.9%)
South Florida (3.9 million feet)	41,824	41,082	1.8%	41,082	38,153	7.7%
Suburban Maryland (2.3 million feet)	46,313	47,742	(3.0%)	47,742	46,811	2.0%
Seattle (1.4 million feet)	17,204	16,151	6.5%	16,151	15,073	7.2%
Total Same Park (26.9 million feet)	392,149	384,504	2.0%	384,504	367,663	4.6%
Adjusted cost of operations						
Northern California	23,155	23,532	(1.6%)	23,532	22,619	4.0%
Southern California	13,683	13,382	2.2%	13,382	13,072	2.4%
Dallas	11,086	10,649	4.1%	10,649	10,635	0.1%
Austin	10,491	9,891	6.1%	9,891	9,487	4.3%
Northern Virginia	25,437	25,018	1.7%	25,018	25,494	(1.9%)
South Florida	11,003	11,349	(3.0%)	11,349	10,578	7.3%
Suburban Maryland	16,362	17,158	(4.6%)	17,158	16,603	3.3%
Seattle	4,385	4,076	7.6%	4,076	3,911	4.2%
Total Same Park	115,602	115,055	0.5%	115,055	112,399	2.4%
Net operating income						
Northern California	76,455	69,500	10.0%	69,500	63,776	9.0%
Southern California	39,190	36,887	6.2%	36,887	34,511	6.9%
Dallas	19,813	20,749	(4.5%)	20,749	19,261	7.7%
Austin	19,117	19,349	(1.2%)	19,349	17,980	7.6%
Northern Virginia	48,381	50,572	(4.3%)	50,572	50,791	(0.4%)
South Florida	30,821	29,733	3.7%	29,733	27,575	7.8%
Suburban Maryland	29,951	30,584	(2.1%)	30,584	30,208	1.2%
Seattle	12,819	12,075	6.2%	12,075	11,162	8.2%
Total Same Park	\$ 276,547	\$ 269,449	2.6%	\$ 269,449	\$ 255,264	5.6%

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Weighted average square foot occupancy

Northern California	97.8%	95.9%	2.0%	95.9%	96.8%	(0.9%)
Southern California	97.6%	96.4%	1.2%	96.4%	96.2%	0.2%
Dallas	89.7%	90.3%	(0.7%)	90.3%	90.0%	0.3%
Austin	92.5%	94.9%	(2.5%)	94.9%	96.9%	(2.1%)
Northern Virginia	92.8%	91.4%	1.5%	91.4%	92.3%	(1.0%)
South Florida	96.4%	97.5%	(1.1%)	97.5%	94.0%	3.7%
Suburban Maryland	89.3%	88.7%	0.7%	88.7%	87.8%	1.0%
Seattle	98.2%	98.1%	0.1%	98.1%	98.5%	(0.4%)
Total Same Park	94.9%	94.4%	0.5%	94.4%	94.3%	0.1%

Revenue per occupied square foot

Northern California	\$ 14.06	\$ 13.39	5.0%	\$ 13.39	\$ 12.32	8.7%
Southern California	\$ 16.50	\$ 15.90	3.8%	\$ 15.90	\$ 15.07	5.5%
Dallas	\$ 11.92	\$ 12.03	(0.9%)	\$ 12.03	\$ 11.50	4.6%
Austin	\$ 16.29	\$ 15.69	3.8%	\$ 15.69	\$ 14.43	8.7%
Northern Virginia	\$ 20.31	\$ 21.10	(3.7%)	\$ 21.10	\$ 21.10	—
South Florida	\$ 11.23	\$ 10.90	3.0%	\$ 10.90	\$ 10.50	3.8%
Suburban Maryland	\$ 22.02	\$ 22.88	(3.8%)	\$ 22.88	\$ 22.65	1.0%
Seattle	\$ 12.60	\$ 11.84	6.4%	\$ 11.84	\$ 11.01	7.5%
Total Same Park	\$ 15.36	\$ 15.15	1.4%	\$ 15.15	\$ 14.50	4.5%

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Supplemental Same Park Data by Product Type

The following supplemental tables provide further detail of our Same Park adjusted rental income, adjusted cost of operations and net operating income by region, further segregated by industrial, flex and office for each of the three years ended December 31, 2018, 2017 and 2016.

	For the Year Ended December 31, 2018				For the Year Ended December 31, 2017				For the Year E	
	Industrial	Flex	Office	Total	Industrial	Flex	Office	Total	Industrial	FL
	In thousands									
Adjusted Rental Income:										
Northern California	\$ 78,721	\$ 9,442	\$ 11,447	\$ 99,610	\$ 72,878	\$ 9,364	\$ 10,790	\$ 93,032	\$ 67,475	\$
Southern California	34,272	17,954	647	52,873	32,516	17,083	670	50,269	30,607	
Dallas	11,566	19,333	—	30,899	11,406	19,992	—	31,398	11,226	
Austin	7,863	21,745	—	29,608	7,316	21,924	—	29,240	6,612	
Northern Virginia	7,350	24,755	41,713	73,818	6,978	25,715	42,897	75,590	6,899	
South Florida	39,810	1,931	83	41,824	38,963	1,911	208	41,082	36,115	
Suburban Maryland	4,464	12,695	29,154	46,313	4,528	12,086	31,128	47,742	4,292	
Seattle	10,474	6,003	727	17,204	9,901	5,675	575	16,151	9,202	
Total	194,520	113,858	83,771	392,149	184,486	113,750	86,268	384,504	172,428	
Adjusted Cost of Operations:										
Northern California	17,628	2,561	2,966	23,155	18,136	2,493	2,903	23,532	17,110	
Southern California	8,619	4,794	270	13,683	8,370	4,743	269	13,382	8,035	
Dallas	3,744	7,342	—	11,086	3,533	7,116	—	10,649	3,589	
Austin	2,690	7,801	—	10,491	2,546	7,345	—	9,891	2,467	
Northern Virginia	2,040	7,427	15,970	25,437	1,982	7,272	15,764	25,018	2,070	
South Florida	10,422	518	63	11,003	10,695	587	67	11,349	10,044	
Suburban Maryland	1,379	3,807	11,176	16,362	1,482	3,883	11,793	17,158	1,516	
Seattle	2,683	1,477	225	4,385	2,385	1,501	190	4,076	2,285	
Total	49,205	35,727	30,670	115,602	49,129	34,940	30,986	115,055	47,116	

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NOI:

Northern California	61,093	6,881	8,481	76,455	54,742	6,871	7,887	69,500	50,365
Southern California	25,653	13,160	377	39,190	24,146	12,340	401	36,887	22,572
Dallas	7,822	11,991	—	19,813	7,873	12,876	—	20,749	7,637
Austin	5,173	13,944	—	19,117	4,770	14,579	—	19,349	4,145
Northern Virginia	5,310	17,328	25,743	48,381	4,996	18,443	27,133	50,572	4,829
South Florida	29,388	1,413	20	30,821	28,268	1,324	141	29,733	26,071
Suburban Maryland	3,085	8,888	17,978	29,951	3,046	8,203	19,335	30,584	2,776
Seattle	7,791	4,526	502	12,819	7,516	4,174	385	12,075	6,917
Total	\$ 145,315	\$ 78,131	\$ 53,101	\$ 276,547	\$ 135,357	\$ 78,810	\$ 55,282	\$ 269,449	\$ 125,312

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As noted above, our past revenue growth has come from contractual annual rent increases, as well as re-leasing of space at current market rates. We believe the percentage difference between outgoing billed rent and incoming billed rent for leases executed (the “Rental Rate Change”) is useful in understanding trends in current market rates relative to our existing lease rates. The following table summarizes the Rental Rate Change and other key statistical information with respect to the Company’s leasing production for its Same Park facilities, on a regional basis, for the year ended December 31, 2018 (square feet in thousands):

Regions	For the Year Ended December 31, 2018			
	Square Footage Leased	Customer Retention	Transaction Costs per Executed Foot	Rental Rate Change (1)
Northern California	1,424	72.6%	\$ 1.29	19.8%
Southern California	1,103	71.3%	\$ 1.44	8.5%
Dallas	911	54.3%	\$ 4.48	2.2%
Austin	546	75.2%	\$ 2.91	7.6%
Northern Virginia	1,131	72.3%	\$ 7.28	(5.3%)
South Florida	1,243	63.1%	\$ 1.16	6.1%
Suburban Maryland	568	74.0%	\$ 7.67	(16.1%)
Seattle	225	52.0%	\$ 2.14	16.4%
Total	7,151	68.2%	\$ 3.30	5.1%

(1) Rental Rate Change is computed by taking the percentage difference between the incoming initial billed monthly rental rates (excluding the impact of certain items such as concessions or future escalators) on new leases or extensions executed in the period, and the outgoing monthly rental rates last billed on the previous lease for that space. Leases executed on spaces vacant for more than the preceding twelve months have been excluded from this measure.

During 2018 and 2017, most markets, with the exception of Northern Virginia and Suburban Maryland, continued to reflect favorable conditions allowing for stable occupancy as well as increasing rental rates. In Northern Virginia and Suburban Maryland, rental rates on executed leases declined 5.3% and 16.1%, respectively, for the year end December 31, 2018, reflecting continued soft market conditions that have persisted for several years due to, among other factors, federal government downsizing. To the extent that such trends continue in these markets, which comprised 30.6% of our Same Park adjusted rental income for the year ended December 31, 2018 and 21.3% of square feet expiring through December 31, 2019, we may continue to face reduced rental income in these markets.

Non-Same Park facilities: The table below reflects the assets comprising our Non-Same Park facilities (in thousands):

Property	Date Acquired	Location	Purchase Price	Square Feet	Occupancy at Acquisition	Occupancy at December 31, 2018
Northern Virginia and Fullerton Road Industrial Parks	June, 2018	Lorton and Springfield, Virginia	\$ 143,766	1,057	76.1%	76.7%
The Grove 270	September, 2016	Rockville, Maryland	13,250	226	18.5%	85.3%
Total			\$ 157,016	1,283	66.0%	78.2%

NOI from the Non-Same Park facilities included \$3.6 million of NOI from the 2018 acquisition for the year ended December 31, 2018. Excluding the results from the 2018 acquisition, the NOI increase from prior year was tied to an increase in occupancy at our 2016 acquisition.

We believe that our management and operating infrastructure typically allows us to generate higher NOI from newly acquired real estate facilities than was achieved by the previous owners. However, it can take 24 or more months for us to fully achieve the higher NOI, and the ultimate levels of NOI to be achieved can be affected by changes in general economic conditions. As a result, there can be no assurance that we will achieve our expectations with respect to newly acquired real estate facilities.

We expect the Non-Same Park facilities to continue to provide increased NOI in 2019 as these facilities increase in occupancy.

Multifamily: As of December 31, 2018, we have a 95.0% interest in Highgate, a 395-unit apartment complex. On January 1, 2018, we began to consolidate the joint venture due to changes to the joint venture agreement that gave the Company control of the joint venture. Prior to January 1, 2018, we accounted for our investment in the joint venture

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using the equity method and accordingly, reflected our share of net loss under “equity in loss of unconsolidated joint venture.”

Highgate began leasing activities during second quarter of 2017. During the year ended December 31, 2018, Highgate generated \$3.3 million of NOI, consisting of \$7.4 million in adjusted rental income and \$4.1 million in adjusted cost of operations.

The following table summarizes Highgate’s project timeline and certain statistics as of December 31, 2018:

Apartment Units	Total Costs (1) (in thousands)	Schedule			As of December 31, 2018	
		Construction Start	Initial Occupancy	Stabilization Period	Physical Occupancy	Average Rent per Unit (2)
395	\$ 115,426	Q3 2015	Q2 2017	Q4 2018	95.9%	\$ 2,093

(1) The project cost for Highgate includes the underlying land at the assigned contribution value upon formation of the joint venture.

(2) Average rent per unit is defined as the total potential monthly rental revenue (actual rent for occupied apartment units plus market rent for vacant apartment units) divided by the total number of rentable apartment units.

Assets sold or held for development: These amounts include historical operating results with respect to properties that have been sold or are held for future potential development.

Depreciation and Amortization Expense: Depreciation and amortization expense increased 5.3% in 2018 compared to 2017 and decreased by 5.2% in 2017 compared to 2016. The increase in 2018 over 2017 was primarily due to depreciation and amortization expense of our multifamily asset as we consolidated its operations effective January 1, 2018 in addition to depreciation and amortization expense from the 2018 acquisition. The decrease in 2017 over 2016 was due to the cost of certain assets reaching the end of their depreciable lives.

General and Administrative Expenses: General and administrative expenses primarily represent compensation for senior executives, tax compliance, legal and costs associated with being a public company. General and administrative expenses increased \$476,000, or 4.9%, in 2018 compared to 2017 and decreased \$5.2 million, or 34.9%, in 2017 compared to 2016. The increase in 2018 over 2017 was primarily due to costs related to the new Chief Financial Officer hired during the latter half of 2018. The decrease in 2017 over 2016 was primarily due to departure of senior

executives in 2016 and 2017 and a reduction in the ongoing LTEIP amortization (\$2.8 million in 2017 versus \$4.7 million in 2016).

Interest and Other Expense: Interest and other expense decreased \$620,000, or 48.2%, in 2018 compared to 2017 and by \$4.4 million, or 77.3%, in 2017 compared to 2016. The decrease in 2018 over 2017 was primarily due to a reduction in borrowings from our revolving Credit Facility. The decrease in 2017 over 2016 was primarily due to a repayment of a \$250.0 million mortgage note during the second quarter of 2016.

Equity loss from investment in and advances to unconsolidated joint venture: Prior to January 1, 2018, we accounted for our joint venture investment using the equity method and recorded our pro-rata share of the net loss in the joint venture. The Company recorded an equity loss in the unconsolidated joint venture of \$805,000, comprised of our proportionate share of \$1.8 million in revenue, \$1.5 million in cost of operations, and \$1.2 million in depreciation expense for the year ended December 31, 2017.

Gain on sale of real estate facilities and gain on sale of development rights: On March 5, 2018, we sold Corporate Pointe Business Park, a park consisting of five multi-tenant office buildings totaling 161,000 square feet located in Orange County, California, for net sale proceeds of \$41.7 million, which resulted in a gain of \$26.8 million. On April 18, 2018, we sold Orange County Business Center, a park consisting of five multi-tenant office buildings totaling 437,000 square feet located in Orange County, California, for net sale proceeds of \$73.3 million, which resulted in a gain of \$50.6 million. On April 30, 2018, we sold Northgate Business Park, a park consisting of seven multi-tenant flex buildings totaling 194,000 square feet located in Dallas, Texas, for net sale proceeds of \$11.8 million, which resulted in a gain of \$7.9 million. On October 31, 2018, we sold Orangewood Office Park, a park consisting of two multi-tenant office buildings totaling 107,000 square feet located in Orange County, California, for net sale proceeds of \$18.3 million, which resulted in a gain of \$8.2 million.

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On May 1, 2017, we sold Empire Commerce, a two-building single-story office park comprising 44,000 square feet, located in Dallas, Texas, for net sale proceeds of \$2.1 million, which resulted in a net gain of \$1.2 million. On March 31, 2017, we sold development rights we held to build medical office buildings on land adjacent to our Westech Business Park in Silver Spring, Maryland for \$6.5 million. We received net sale proceeds of \$6.4 million, of which \$1.5 million was received in prior years and \$4.9 million was received in 2017. We recorded a net gain of \$6.4 million for the year ended December 31, 2017.

Liquidity and Capital Resources

This section should be read in conjunction with our consolidated statements of cash flows for the years ended December 31, 2018, 2017 and 2016 and the notes to our consolidated financial statements, which set forth the major components of our historical liquidity and capital resources. The discussion below sets forth the factors which we expect will affect our future liquidity and capital resources or which may vary substantially from historical levels.

Capital Raising Strategy: As a REIT, we generally distribute substantially all of our “REIT taxable income” to our shareholders, which relative to a taxable C corporation, limits the amount of cash flow from operations that we can retain for investments. As a result, in order to grow our asset base, access to capital is important.

Our financial profile is characterized by strong credit metrics, including low leverage relative to our total capitalization and operating cash flows. We are a highly rated REIT, as rated by Moody’s and Standard & Poor’s. Our corporate credit rating by Standard and Poors is A-, while our preferred shares are rated BBB by Standard and Poors and Baa2 by Moodys. Our credit profile and ratings enable us to effectively access both the public and private capital markets to raise capital.

In order to maintain access to capital markets, we target a minimum ratio of FFO (as defined below) to combined fixed charges and preferred distributions of 3.0 to 1.0. Fixed charges include interest expense, capitalized interest and preferred distributions paid to preferred shareholders. For the year ended December 31, 2018, the ratio to FFO to combined fixed charges and preferred distributions paid was 5.3 to 1.0.

We have a \$250.0 million revolving Credit Facility that can be expanded to \$400.0 million which expires in January, 2022. We use the Credit Facility as temporary financing until we are able to raise longer term capital as necessary. Historically we have funded our long-term capital requirements with retained operating cash flow and proceeds from the issuance of common and preferred securities. We will select among these sources of capital based upon availability, relative cost, the impact of constraints of certain forms of capital on our operations (such as covenants), as well as the desire for leverage.

Short-term Liquidity and Capital Resource Analysis: We believe that our net cash provided by our operating activities will continue to be sufficient to enable us to meet our ongoing requirements for debt service, capital expenditures and distributions to our shareholders for the foreseeable future.

As of December 31, 2018, we had \$37.4 million in cash unrestricted. In the last five years, we have retained approximately \$40 to \$60 million in operating cash flow per year. Retained operating cash flow represents cash flow provided by operating activities, less shareholder and unit holder distributions and capital expenditures.

Required Debt Repayment: As of December 31, 2018, we have no debt outstanding on our Credit Facility. We are in compliance with the covenants and all other requirements of our Credit Facility.

Capital Expenditures: We define recurring capital expenditures as those necessary to maintain and operate our real estate at its current economic value. Nonrecurring capital improvements include property renovations and expenditures related to repositioning acquisitions. The following table sets forth our capital expenditures paid for in the years ended December 31, 2018, 2017 and 2016 on an aggregate and per square foot basis:

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	For the Years Ended December 31,					
	2018	2017	2016	2018	2017	2016
Commercial Real Estate	(in thousands)			(per total weighted average square foot)		
Recurring capital expenditures						
Capital improvements (1)	\$ 10,738	\$ 10,069	\$ 8,336	\$ 0.38	\$ 0.36	\$ 0.30
Tenant improvements	18,688	28,294	16,086	0.67	1.01	0.57
Lease commissions	8,048	7,477	6,530	0.29	0.27	0.23
Total commercial recurring capital expenditures	37,474	45,840	30,952	1.34	1.64	1.10
Nonrecurring capital improvements	1,176	4,379	925	0.05	0.16	0.03
Total commercial capital expenditures (1)	\$ 38,650	\$ 50,219	\$ 31,877	\$ 1.39	\$ 1.80	\$ 1.13

(1) Excludes \$13 of recurring capital improvements on our multifamily asset in 2018.

The following table summarizes Same Park, Non-Same Park, multifamily and assets sold or held for development recurring capital expenditures paid and the related percentage of NOI by region for the years ended December 31, 2018, 2017 and 2016 (in thousands):

Region	For the Years Ended December 31,						Recurring Capital Expenditures as a Percentage of NOI		
	2018	2017	Change	2017	2016	Change	2018	2017	2016
Same Park									
Northern California	\$ 3,602	\$ 3,642	(1.1%)	\$ 3,642	\$ 3,556	2.4%	4.7%	5.2%	5.6%
Southern California	3,167	3,025	4.7%	3,025	2,804	7.9%	8.1%	8.2%	8.1%
Dallas	5,027	3,813	31.8%	3,813	3,972	(4.0%)	25.4%	18.4%	20.6%
Austin	2,362	1,726	36.8%	1,726	1,263	36.7%	12.4%	8.9%	7.0%
Northern Virginia	10,810	13,379	(19.2%)	13,379	7,441	79.8%	22.3%	26.5%	14.7%
South Florida	3,149	2,055	53.2%	2,055	2,713	(24.3%)	10.2%	6.9%	9.8%
Suburban Maryland	6,114	10,026	(39.0%)	10,026	5,774	73.6%	20.4%	32.8%	19.1%
Seattle	968	763	26.9%	763	1,132	(32.6%)	7.6%	6.3%	10.1%
Total Same Park	35,199	38,429	(8.4%)	38,429	28,655	34.1%	12.7%	14.3%	11.2%
Non-Same Park									
Northern Virginia	615	—	100.0%	—	—	—	—	—	—
	1,049	5,548	(81.1%)	5,548	164	3,282.9%	—	—	—

Suburban Maryland Total Non-Same Park	1,664	5,548	(70.0%)	5,548	164	3,282.9%	—	—	—
Assets sold or held for development	611	1,863	(67.2%)	1,863	2,133	(12.7%)	19.9%	19.4%	19.4%
Total commercial recurring capital expenditures	37,474	45,840	(18.3%)	45,840	30,952	48.1%	—	—	—
Multifamily	13	—	100.0%	—	—	—	—	—	—
Total	\$ 37,487	\$ 45,840	(18.2%)	\$ 45,840	\$ 30,952	48.1%	13.0%	16.4%	11.6%

The decrease in Same Park recurring capital expenditures of \$3.2 million, or 8.4%, was primarily due to transaction costs related to large renewals and leasing production in 2017. The decrease in Non-Same Park recurring capital expenditures are related to substantially completing the repositioning and lease-up of a facility in 2017.

In the last five years, our recurring capital expenditures have averaged generally between \$1.10 and \$1.64 per square foot, and 11.6% and 18.8% as a percentage of NOI.

Redemption of Preferred Stock: Historically, we have reduced our cost of capital by refinancing higher coupon preferred securities with lower coupon preferred securities. On January 3, 2018, we completed the redemption of the remaining 6.0% Series T preferred shares outstanding of \$130.0 million using funds received from our 5.20% Series Y preferred shares issued during December, 2017.

At December 31, 2018, our 5.75% Series U preferred shares, with a par value of \$230.0 million, and our 5.70% Series V preferred shares, with a par value of \$110.0 million, were redeemable at par. Redemption of such preferred shares will depend upon many factors, including the cost of capital. None of our preferred securities are redeemable at the option of the holders.

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Acquisitions of real estate facilities: On June 8, 2018, we acquired two multi-tenant industrial parks aggregating 1.1 million rentable square feet in Springfield, Virginia, for a net purchase price of \$143.8 million. We have acquired real estate facilities in the past, and we continue to seek to acquire additional real estate facilities; however, there is significant competition to acquire existing facilities and there can be no assurance as to the volume of future acquisition activity.

Sale of real estate: During the year ended December 31, 2018, we sold real estate facilities for net sale proceeds of \$145.1 million resulting in total gain of \$93.5 million.

Development of real estate facilities: As noted above, we have an additional 123,000 square foot vacant building located within The Mile that we are seeking to develop into another multifamily property. There can be no assurance as to the timing or amount of any investment that may occur; however, we do not expect to incur any significant development costs on this potential project any earlier than the first quarter of 2020.

Repurchase of Common Stock: No shares of common stock were repurchased under the board-approved common stock repurchase program during the years ended December 31, 2018, 2017 and 2016. As of December 31, 2018, management has the authorization to repurchase an additional 1,614,721 shares.

Requirement to Pay Distributions: For all periods presented herein, we have elected to be treated as a REIT, as defined in the Code. As a REIT, we do not incur federal income tax on our "REIT taxable income" (generally, net rents and gains from real property, dividends and interest) that is fully distributed each year (for this purpose, certain distributions paid in a subsequent year may be considered), and if we meet certain organizational and operational rules. We believe we have met these requirements in all periods presented herein, and we expect to continue to elect and qualify as a REIT.

We paid REIT qualifying distributions of \$156.4 million (\$52.6 million to preferred shareholders and \$103.8 million to common shareholders) during the year ended December 31, 2018.

We estimate the annual distribution requirements with respect to our preferred shares outstanding at December 31, 2018 to be \$51.8 million per year.

During the second quarter of 2018, the Board increased our quarterly dividend from \$0.85 per common share to \$1.05 per common share, which is an increase of \$0.20, or 23.5%, over the previous quarter's distributions. Our consistent, long-term dividend policy has been to distribute only our taxable income. Future quarterly distributions with respect to the common shares will continue to be determined based upon our REIT distribution requirements and, after taking

into consideration distributions to the preferred shareholders, will be funded with cash provided by operating activities.

Funds from Operations and Core Funds from Operations

Funds from Operations (“FFO”) is a non-GAAP measure defined by the National Association of Real Estate Investment Trusts and is considered a helpful measure of REIT performance by REITs and many REIT analysts. FFO represents GAAP net income before real estate depreciation and amortization expense, gains or losses from sales of operating properties and impairment charges on operating properties and real estate equity investments.

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The following table reconciles from net income allocable to common shareholders to FFO and net income per share to FFO per share (amounts in thousands, except per share data):

	For The Years Ended December 31,				
	2018	2017	2016	2015	2014
Net income allocable to common shareholders	\$ 172,899	\$ 90,425	\$ 62,872	\$ 68,291	\$ 113,154
Adjustments					
Gain on sale of land, real estate facilities and development rights	(93,484)	(7,574)	—	(28,235)	(92,373)
Depreciation and amortization expense	99,242	94,270	99,486	105,394	110,357
Depreciation from unconsolidated joint venture	—	1,180	—	—	—
Net income allocated to noncontrolling interests	45,199	24,279	16,955	18,495	30,729
Net income allocated to restricted stock unit holders	1,923	761	569	299	329
FFO allocated to joint venture partner	(13)	—	—	—	—
FFO allocable to common and dilutive shares	\$ 225,766	\$ 203,341	\$ 179,882	\$ 164,244	\$ 162,196
Weighted average outstanding					
Common shares	27,321	27,207	27,089	26,973	26,899
Common operating partnership units	7,305	7,305	7,305	7,305	7,305
Restricted stock units	182	187	290	130	69
Common share equivalents	101	205	90	78	101
Total common and dilutive shares	34,909	34,904	34,774	34,486	34,374
Net income per common share — diluted	\$ 6.31	\$ 3.30	\$ 2.31	\$ 2.52	\$ 4.19
Gain on sale of land, real estate facilities and development rights	(2.68)	(0.21)	—	(0.82)	(2.68)
Depreciation and amortization expense, including amounts					
from investments in unconsolidated joint venture	2.84	2.74	2.86	3.06	3.21
FFO per share	\$ 6.47	\$ 5.83	\$ 5.17	\$ 4.76	\$ 4.72

We also present “Core FFO per share,” a non-GAAP measure that represents FFO per share excluding the net impact of (i) income allocated to preferred shareholders to the extent redemption value exceeds the related carrying value (a “Preferred Redemption Allocation”), (ii) compensatory arrangements related to the departure of senior executives and (iii) certain other non-cash and/or nonrecurring income or expense items. The following table reconciles FFO per share to Core FFO per share:

	For The Years Ended December 31,				
	2018	2017	2016	2015	2014
FFO per share	\$ 6.47	\$ 5.83	\$ 5.17	\$ 4.76	\$ 4.72

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Preferred Redemption Allocation	—	0.31	0.21	0.07	—
Lease buyout payments	—	—	(0.01)	—	—
Net impact due to departure of senior executives	—	(0.01)	0.06	—	—
Acquisition transaction costs	—	—	0.01	—	0.01
Core FFO per share	\$ 6.47	\$ 6.13	\$ 5.44	\$ 4.83	\$ 4.73

We believe FFO and Core FFO assist investors in analyzing and comparing the operating and financial performance of a company's real estate between periods. FFO and Core FFO are not substitutes for GAAP net income. In addition, other REITs may compute these measures differently, so comparisons among REITs may not be helpful.

Off-Balance Sheet Arrangements: The Company does not have any off-balance sheet arrangements that have or are reasonably likely to have a material effect on the Company's financial condition, results of operations, liquidity, capital expenditures or capital resources.

Contractual Obligations: As of December 31, 2018, the Company is scheduled to pay cash dividends of \$51.8 million per year on its preferred equity outstanding. Dividends on preferred equity are paid when and if declared by the Company's Board and accumulate if not paid. Shares of preferred equity are redeemable by the Company in order to preserve its status as a REIT and are also redeemable five years after issuance, but are not redeemable at the option of the holder.

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Our significant contractual obligations as of December 31, 2018 and their impact on our cash flows and liquidity are summarized below (in thousands):

Contractual Obligations	Payments Due by Period				
	Total	Less than 1 year	1 - 3 years	4 - 5 years	More than 5 years
Transaction costs (1)	\$ 9,764	\$ 9,764	\$ —	\$ —	\$ —
Ground lease obligations (2)	2,106	141	594	397	974
Total	\$ 11,870	\$ 9,905	\$ 594	\$ 397	\$ 974

(1) Represents transaction costs, including tenant improvements and lease commissions, which we are committed to under the terms of executed leases.

(2) Represents future contractual payments on land under various operating leases.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

To limit the Company's exposure to market risk, the Company principally finances its operations and growth with permanent equity capital consisting of either common or preferred stock. The Company had no debt outstanding as of as of December 31, 2018.

Our exposure to market risk for changes in interest rates relates primarily to the Credit Facility, which is subject to variable interest rates. See Notes 2 and 6 to the consolidated financial statements included in this Form 10-K for additional information regarding the terms, valuations and approximate principal maturities of the Company's indebtedness, including the Credit Facility. Based on borrowing rates currently available to the Company, the difference between the carrying amount of debt and its fair value is insignificant.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The financial statements of the Company at December 31, 2018 and 2017 and for the years ended December 31, 2018, 2017 and 2016 and the report of Ernst & Young LLP, independent registered public accounting firm, thereon and the

related financial statement schedule, are included elsewhere herein. Reference is made to the Index to Consolidated Financial Statements and Schedules in Item 15.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of December 31, 2018. These controls and procedures have been designed to ensure that information required for disclosure is recorded, processed, summarized and reported within the requisite time periods and that such information is accumulated and communicated to management. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of the Company's disclosure controls and procedures as of December 31, 2018, the Company's Chief Executive Officer and Chief Financial Officer concluded that, as of such date, the Company's disclosure controls and procedures were effective at the reasonable assurance level.

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Management's Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in Internal Control-Integrated Framework issued by the Committee on Sponsoring Organizations of the Treadway Commission (2013 Framework). Based on that evaluation, our management concluded that our internal control over financial reporting was effective as of December 31, 2018.

The effectiveness of the Company's internal control over financial reporting as of December 31, 2018 has been audited by Ernst & Young LLP, an independent registered public accounting firm, as stated in their attestation report which is included herein.

Changes in Internal Control Over Financial Reporting

There have not been any changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fourth quarter of 2018 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of

PS Business Parks, Inc.

Opinion on Internal Control over Financial Reporting

We have audited PS Business Parks, Inc.'s internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) (the COSO criteria). In our opinion, PS Business Parks, Inc. (the Company) maintained, in all material aspects, effective internal control over financial reporting as of December 31, 2018, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated balance sheets of PS Business Parks, Inc. as of December 31, 2018 and 2017, and the related consolidated statements of income, equity and cash flows for each of the three years in the period ended December 31, 2018, and the related notes and financial statement schedule listed in the Index at Item 15(a) and our report dated February 25, 2019 expressed an unqualified opinion thereon.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Security and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects.

Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ Ernst & Young LLP

Los Angeles, California

February 25, 2019

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ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this item with respect to directors is hereby incorporated by reference to the material appearing in the Company's definitive proxy statement to be filed in connection with the annual shareholders' meeting to be held in 2019 (the "Proxy Statement") under the caption "Election of Directors."

The following is a biographical summary of the executive officers of the Company:

Maria R. Hawthorne, age 59, was named Chief Executive Officer and elected as a Director of the Company in July, 2016. Ms. Hawthorne was promoted to President in August, 2015 and continues to serve as President of the Company. Ms. Hawthorne most recently served as Executive Vice President, Chief Administrative Officer of the Company from July, 2013 to July, 2015. Ms. Hawthorne served as Executive Vice President, East Coast from February, 2011 to July, 2013. Ms. Hawthorne was Senior Vice President from March, 2004 to February, 2011, with responsibility for property operations on the East Coast, which includes Northern Virginia, Maryland and South Florida. From June, 2001 through March, 2004, Ms. Hawthorne was Vice President of the Company, responsible for property operations in Virginia. From July, 1994 to June, 2001, Ms. Hawthorne was a Regional Manager of the Company in Virginia. From August, 1988 to July, 1994, Ms. Hawthorne was a General Manager, Leasing Director and Property Manager for American Office Park Properties. Ms. Hawthorne earned a Bachelor of Arts Degree in International Relations from Pomona College.

John W. Petersen, age 55, has been Executive Vice President and Chief Operating Officer since he joined the Company in December, 2004. Prior to joining the Company, Mr. Petersen was Senior Vice President, San Jose Region, for Equity Office Properties ("EOP") from July, 2001 to December, 2004, responsible for 11.3 million square feet of multi-tenant office, industrial and R&D space in Silicon Valley. Prior to EOP, Mr. Petersen was Senior Vice President with Spieker Properties, from 1995 to 2001 overseeing the growth of that company's portfolio in San Jose, through acquisition and development of nearly three million square feet. Mr. Petersen is a graduate of The Colorado College in Colorado Springs, Colorado, and was recently the President of National Association of Industrial and Office Parks, Silicon Valley Chapter.

Jeffrey D. Hedges, age 36, joined the Company as Executive Vice President, Chief Financial Officer, Secretary, and principal financial officer on September 17, 2018. Prior to joining the Company, Mr. Hedges served as Senior Vice President, Accounting and Reporting from 2015 at Invitation Homes (NYSE:INVH) (formerly known as Starwood Waypoint Homes and prior to that Colony Starwood Homes), a publicly traded single-family REIT that owns and operates single-family rental homes in the United States. Mr. Hedges was a Senior Manager in the Transaction Advisory Services and Assurance (Audit) groups at Ernst & Young from 2006 to 2015. Mr. Hedges is a certified public accountant and holds a Bachelor of Science from the W.P. Carey School of Business, Arizona State University, and a Master of Business Administration from the Wharton School, University of Pennsylvania.

Trenton Groves, age 46, has served as the Company's Senior Vice President, Chief Accounting Officer, Assistant Secretary, and principal accounting officer since September 2018. Mr. Groves joined the Company as Corporate Controller in 2004 and has served as Vice President, Finance, and Corporate Controller since 2007. Prior to joining the Company, Mr. Groves was in public accounting, serving as a Manager in the Assurance (Audit) group at Ernst & Young from 2002 to 2004 and as Manager at Arthur Anderson from 1998 to 2002. Mr. Groves is a certified public accountant and holds a Bachelor of Science in accounting from California State University, Northridge.

Information required by this item with respect to the nominating process, the audit committee and the audit committee financial expert is hereby incorporated by reference to the material appearing in the Proxy Statement under the caption "Corporate Governance and Board Matters."

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Information required by this item with respect to a code of ethics is hereby incorporated by reference to the material appearing in the Proxy Statement under the caption “Corporate Governance and Board Matters.” We have adopted a code of ethics that applies to our principal executive officer, principal financial officer and principal accounting officer, which is available on our website at www.psbusinessparks.com. The information contained on the Company’s website is not a part of, or incorporated by reference into, this Annual Report on Form 10-K. Any amendments to or waivers of the code of ethics granted to the Company’s executive officers or the controller will be published promptly on our website or by other appropriate means in accordance with SEC rules.

Information required by this item with respect to the compliance with Section 16(a) of the Exchange Act is hereby incorporated by reference to the material appearing in the Proxy Statement under the caption “Section 16(a) Beneficial Ownership Reporting Compliance.”

ITEM 11. EXECUTIVE COMPENSATION

The information required by this item is hereby incorporated by reference to the material appearing in the Proxy Statement under the captions “Corporate Governance and Board Matters,” “Executive Compensation,” “Corporate Governance and Board Matters — Compensation Committee Interlocks and Insider Participation” and “Report of the Compensation Committee.”

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by this item with respect to security ownership of certain beneficial owners and management is hereby incorporated by reference to the material appearing in the Proxy Statement under the caption “Stock Ownership of Certain Beneficial Owners and Management.”

The following table sets forth information as of December 31, 2018 on the Company’s equity compensation plans:

(a)	(b)	(c)
Number of	Weighted	Number of Securities
Securities to be	Average	Remaining Available
Issued Upon		for
		Future Issuance under

Plan Category	Exercise of Outstanding Options, Warrants and Rights	Exercise Price of Outstanding Options, Warrants and Rights	Equity Compensation Plans (Excluding Securities Reflected in Column (a))
Equity compensation plans approved by security holders	386,705	\$ 92.53	846,458
Equity compensation plans not approved by security holders	—	—	—
Total	386,705	* \$ 92.53	* 846,458

*Amounts include restricted stock units.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by this item is hereby incorporated by reference to the material appearing in the Proxy Statement under the captions “Corporate Governance and Board Matters” and “Certain Relationships and Related Transactions.”

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by this item is hereby incorporated by reference to the material appearing in the Proxy Statement under the caption “Ratification of Independent Registered Public Accountants.”

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PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

a.1. Financial Statements

The financial statements listed in the accompanying Index to Consolidated Financial Statements and Schedules are filed as part of this report.

2. Financial Statements Schedule

The financial statements schedule listed in the accompanying Index to Consolidated Financial Statements and Schedules are filed as part of this report.

3. Exhibits

The exhibits listed in the Exhibit Index immediately preceding such exhibits are filed with or incorporated by reference in this report.

b. Exhibits

The exhibits listed in the Exhibit Index immediately preceding such exhibits are filed with or incorporated by reference in this report.

c. Financial Statement Schedules

Not applicable.

ITEM 16. FORM 10-K SUMMARY

None.

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PS BUSINESS PARKS, INC.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS AND SCHEDULES

(Item 15(a)(1) and Item 15(a)(2))

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<u>Consolidated balance sheets as of December 31, 2018 and 2017</u>	45
<u>Consolidated statements of income for the years ended December 31, 2018, 2017 and 2016</u>	46
<u>Consolidated statements of equity for the years ended December 31, 2018, 2017 and 2016</u>	47
<u>Consolidated statements of cash flows for the years ended December 31, 2018, 2017 and 2016</u>	48
<u>Notes to consolidated financial statements</u>	50
Schedule:	
<u>III — Real estate and accumulated depreciation</u>	68

All other schedules have been omitted since the required information is not present or not present in amounts sufficient to require submission of the schedule, or because the information required is included in the consolidated financial statements or notes thereto.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of

PS Business Parks, Inc.

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of PS Business Parks, Inc. (the Company) as of December 31, 2018 and 2017, and the related consolidated statements of income, equity and cash flows for each of the three years in the period ended December 31, 2018, and the related notes and financial statement schedule listed in the Index at Item 15(a) (collectively referred to as the “consolidated financial statements”). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company at December 31, 2018 and 2017, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2018, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company’s internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework), and our report dated February 25, 2019 expressed an unqualified opinion thereon.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company’s financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Security and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to

those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ Ernst & Young LLP

We have served as the Company's auditor since 1997.

Los Angeles, California

February 25, 2019

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PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES (Item 15(a)(1) and Item 15(a)(2))

PS BUSINESS PARKS, INC.

CONSOLIDATED BALANCE SHEETS

(Amounts in thousands, except share data)

	December 31,	
	2018	2017
ASSETS		
Cash and cash equivalents	\$ 37,379	\$ 114,882
Real estate facilities, at cost		
Land	816,656	769,036
Buildings and improvements	2,374,943	2,156,862
	3,191,599	2,925,898
Accumulated depreciation	(1,241,116)	(1,161,798)
	1,950,483	1,764,100
Properties held for sale, net	—	49,259
Land and building held for development	30,848	29,665
	1,981,331	1,843,024
Investment in and advances to unconsolidated joint venture	—	100,898
Rent receivable, net	1,403	1,876
Deferred rent receivable, net	33,308	32,062
Other assets	15,173	7,417
Total assets	\$ 2,068,594	\$ 2,100,159
LIABILITIES AND EQUITY		
Accrued and other liabilities	\$ 85,141	\$ 80,223
Preferred stock called for redemption	—	130,000

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Total liabilities	85,141	210,223
Commitments and contingencies		
Equity		
PS Business Parks, Inc.'s shareholders' equity		
Preferred stock, \$0.01 par value, 50,000,000 shares authorized, 38,390 shares issued and outstanding at December 31, 2018 and 2017	959,750	959,750
Common stock, \$0.01 par value, 100,000,000 shares authorized, 27,362,101 and 27,254,607 shares issued and outstanding at December 31, 2018 and 2017, respectively	274	272
Paid-in capital	736,131	735,067
Accumulated earnings (deficit)	69,207	(1,778)
Total PS Business Parks, Inc.'s shareholders' equity	1,765,362	1,693,311
Noncontrolling interests	218,091	196,625
Total equity	1,983,453	1,889,936
Total liabilities and equity	\$ 2,068,594	\$ 2,100,159

See accompanying notes.

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PS BUSINESS PARKS, INC.

CONSOLIDATED STATEMENTS OF INCOME

(Amounts in thousands, except per share data)

	For The Years Ended December 31,		
	2018	2017	2016
Rental income	\$ 413,516	\$ 402,179	\$ 386,871
Expenses			
Cost of operations	126,547	125,340	123,108
Depreciation and amortization	99,242	94,270	99,486
General and administrative	10,155	9,679	14,862
Total operating expenses	235,944	229,289	237,456
Interest and other income	1,510	942	1,233
Interest and other expense	(665)	(1,285)	(5,664)
Equity in loss of unconsolidated joint venture	—	(805)	—
Gain on sale of real estate facilities	93,484	1,209	—
Gain on sale of development rights	—	6,365	—
Net income	271,901	179,316	144,984
Allocation to noncontrolling interests	(45,199)	(24,279)	(16,955)
Net income allocable to PS Business Parks, Inc.	226,702	155,037	128,029
Allocation to preferred shareholders based upon			
Distributions	(51,880)	(52,873)	(57,276)
Redemptions (Note 10)	—	(10,978)	(7,312)
Allocation to restricted stock unit holders	(1,923)	(761)	(569)
Net income allocable to common shareholders	\$ 172,899	\$ 90,425	\$ 62,872
Net income per common share			
Basic	\$ 6.33	\$ 3.32	\$ 2.32
Diluted	\$ 6.31	\$ 3.30	\$ 2.31
Weighted average common shares outstanding			
Basic	27,321	27,207	27,089
Diluted	27,422	27,412	27,179

See accompanying notes.

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PS BUSINESS PARKS, INC.

CONSOLIDATED STATEMENTS OF EQUITY

(Amounts in thousands, except share data)

	Preferred Stock		Common Stock		Paid-in Capital	Accumulated Earnings (Deficit)	Total PS Business Parks, Inc.'s Shareholders' Equity	Noncontrolling Interests	Total Equity
	Shares	Amount	Shares	Amount			Equity		
Balances at December 31, 2015	36,800	\$ 920,000	27,034,073	\$ 269	\$ 722,009	\$ 18,218	\$ 1,660,496	\$ 200,103	\$ 1,860,599
Cumulative effect of a change in accounting principle (Note 11)	—	—	—	—	807	(807)	—	—	—
Issuance of preferred stock, net of issuance costs	7,590	189,750	—	—	(6,434)	—	183,316	—	183,316
Redemption of preferred stock, net of issuance costs	(9,200)	(230,000)	—	—	7,312	(7,312)	(230,000)	—	(230,000)
Issuance of common stock in connection with stock-based compensation	—	—	104,065	2	3,886	—	3,888	—	3,888
Stock compensation, net	—	—	—	—	8,404	—	8,404	—	8,404
Net income	—	—	—	—	—	128,029	128,029	16,955	144,984
Distributions									
Preferred stock	—	—	—	—	—	(57,276)	(57,276)	—	(57,276)
Common stock	—	—	—	—	—	(81,285)	(81,285)	—	(81,285)

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Noncontrolling interests	—	—	—	—	—	—	—	(21,916)	(21,916)
Adjustment to noncontrolling interests in the OP	—	—	—	—	(2,313)	—	(2,313)	2,313	—
Balances at December 31, 2016	35,190	879,750	27,138,138	271	733,671	(433)	1,613,259	197,455	1,810,714
Issuance of preferred stock, net of issuance costs	17,200	430,000	—	—	(14,221)	—	415,779	—	415,779
Redemption of preferred stock, net of issuance costs	(14,000)	(350,000)	—	—	10,978	(10,978)	(350,000)	—	(350,000)
Issuance of common stock in connection with stock-based compensation	—	—	116,469	1	4,217	—	4,218	—	4,218
Stock compensation, net	—	—	—	—	4,016	—	4,016	—	4,016
Cash paid for taxes in lieu of shares upon vesting of restricted stock units	—	—	—	—	(3,865)	—	(3,865)	—	(3,865)
Net income	—	—	—	—	—	155,037	155,037	24,279	179,316
Distributions									
Preferred stock	—	—	—	—	—	(52,873)	(52,873)	—	(52,873)
Common stock	—	—	—	—	—	(92,531)	(92,531)	—	(92,531)
Noncontrolling interests	—	—	—	—	—	—	—	(24,838)	(24,838)
Adjustment to noncontrolling interests in the OP	—	—	—	—	271	—	271	(271)	—
Balances at December 31, 2017	38,390	959,750	27,254,607	272	735,067	(1,778)	1,693,311	196,625	1,889,936
Issuance of common stock in connection	—	—	107,494	2	3,008	—	3,010	—	3,010

with stock-based compensation									
Stock compensation, —	—	—	—	3,032	—	3,032	—	3,032	—
net									
Cash paid for taxes in lieu of shares upon vesting of restricted stock —	—	—	—	(4,981)	—	(4,981)	—	(4,981)	—
units									
Consolidation of joint venture— (see Note 3)	—	—	—	—	—	—	4,032	4,032	—
Net income —	—	—	—	—	—	226,702	226,702	45,199	271,901
Distributions									
Preferred stock —	—	—	—	—	—	(51,880)	(51,880)	—	(51,880)
Common stock —	—	—	—	—	—	(103,837)	(103,837)	—	(103,837)
Noncontrolling interests	—	—	—	—	—	—	—	(27,760)	(27,760)
Adjustment to noncontrolling interests in the OP —	—	—	—	5	—	5	(5)	—	—
Balances at December 31, 2018	38,390	\$ 959,750	27,362,101	\$ 274	\$ 736,131	\$ 69,207	\$ 1,765,362	\$ 218,091	\$ 1,983,451

See accompanying notes.

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PS BUSINESS PARKS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Amounts in thousands)

	For The Years Ended December 31,		
	2018	2017	2016
Cash flows from operating activities			
Net income	\$ 271,901	\$ 179,316	\$ 144,984
Adjustments to reconcile net income to net cash provided by operating activities			
Depreciation and amortization expense	99,242	94,270	99,486
Tenant improvement reimbursements, net of lease incentives	(2,226)	(2,183)	(1,666)
Equity in loss of unconsolidated joint venture	—	805	—
Gain on sale of real estate facilities and development rights	(93,484)	(7,574)	—
Stock compensation	4,174	4,777	10,913
Amortization of financing costs	537	475	523
Other, net	(3,991)	1,728	(3,733)
Total adjustments	4,252	92,298	105,523
Net cash provided by operating activities	276,153	271,614	250,507
Cash flows from investing activities			
Capital expenditures to real estate facilities	(38,663)	(50,219)	(31,877)
Capital expenditures to land and building held for development	(1,183)	(1,549)	(49)
Investment in and advances to unconsolidated joint venture	—	(34,513)	(40,454)
Acquisition of real estate facilities	(142,399)	—	(12,628)
Proceeds from sale of real estate facilities	145,097	2,144	—
Proceeds from sale of development rights	—	4,900	—
Consolidation of joint venture	1,082	—	—
Net cash used in investing activities	(36,066)	(79,237)	(85,008)
Cash flows from financing activities			
Borrowings on credit facility	50,000	250,000	116,000
Repayment of borrowings on credit facility	(50,000)	(250,000)	(116,000)
Repayment of mortgage note payable	—	—	(250,000)
Payment of financing costs	(307)	(858)	—
Proceeds from the exercise of stock options	3,010	4,218	3,888
Cash paid for taxes in lieu of shares upon vesting of restricted stock units	(4,981)	(3,865)	(1,940)
Redemption of preferred stock	(130,000)	(450,000)	—
Net proceeds from the issuance of preferred stock	—	415,779	183,316
Cash paid to restricted stock unit holders	(1,142)	(761)	(569)
Distributions paid to preferred shareholders	(52,573)	(52,180)	(57,276)
Distributions paid to common shareholders	(103,837)	(92,531)	(81,285)

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Distributions paid to noncontrolling interests—common units	(27,760)	(24,838)	(21,916)
Net cash used in financing activities	(317,590)	(205,036)	(225,782)
Net decrease in cash and cash equivalents	(77,503)	(12,659)	(60,283)
Cash, cash equivalents and restricted cash at the beginning of the period	115,970	128,629	188,912
Cash, cash equivalents and restricted cash at the end of the period	\$ 38,467	\$ 115,970	\$ 128,629
Supplemental disclosures			
Interest paid	\$ 40	\$ 1,188	\$ 7,395

See accompanying notes.

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PS BUSINESS PARKS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Amounts in thousands)

	For The Years Ended December 31,		
	2018	2017	2016
Supplemental schedule of non-cash investing and financing activities			
Adjustment to noncontrolling interests—common units in OP			
Noncontrolling interests—common units	\$ (5)	\$ (271)	\$ 2,313
Paid-in capital	\$ 5	\$ 271	\$ (2,313)
Consolidation of joint venture			
Land	\$ 21,814	\$ —	\$ —
Buildings and improvements	\$ 84,903	\$ —	\$ —
Other, net	\$ (1,787)	\$ —	\$ —
Investment in and advances to unconsolidated joint venture	\$ (100,898)	\$ —	\$ —
Noncontrolling interests—joint venture	\$ (4,032)	\$ —	\$ —
Preferred redemption allocation			
Paid-in capital	\$ —	\$ 10,978	\$ 7,312
Accumulated earnings (deficit)	\$ —	\$ (10,978)	\$ (7,312)
Preferred stock called for redemption			
Preferred stock called for redemption and reclassified to liabilities	\$ —	\$ 130,000	\$ 230,000
Preferred stock called for redemption and reclassified from equity	\$ —	\$ (130,000)	\$ (230,000)
Accrued preferred stock distributions			
Accrued and other liabilities	\$ —	\$ 693	\$ —
Accumulated earnings (deficit)	\$ —	\$ (693)	\$ —
Transfer to land and building held for development			
Land	\$ —	\$ —	\$ (9,676)
Buildings and improvements	\$ —	\$ —	\$ (19,092)
Accumulated depreciation	\$ —	\$ —	\$ 7,870
Land and building held for development	\$ —	\$ —	\$ 20,898
Cumulative effect of a change in accounting principle (Note 11)			
Paid-in capital	\$ —	\$ —	\$ 807
Accumulated earnings (deficit)	\$ —	\$ —	\$ (807)

See accompanying notes.

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PS BUSINESS PARKS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2018

1. Organization and description of business

Organization

PS Business Parks, Inc. (“PSB”) was incorporated in the state of California in 1990. As of December 31, 2018, PSB owned 78.9% of the common partnership units of PS Business Parks, L.P. (the “OP”). The remaining common partnership units are owned by Public Storage (“PS”). PS’s interest in the OP is referred to as the “PS OP Interests.” PSB, as the sole general partner of the OP, has full, exclusive and complete responsibility and discretion in managing and controlling the OP. PSB and its subsidiaries, including the OP and our consolidated joint venture, are collectively referred to as the “Company,” “we,” “us,” or “our.” PS would own 41.7% (or 14.5 million shares) of the outstanding shares of the Company’s common stock if it redeemed its common partnership units for common shares.

Description of business

The Company is a fully-integrated, self-advised and self-managed real estate investment trust (“REIT”) that owns, operates, acquires and develops commercial properties, primarily multi-tenant industrial, flex and office space. As of December 31, 2018, the Company owned and operated 28.2 million rentable square feet of commercial space in six states and held a 95.0% interest in a 395-unit multifamily apartment complex. The Company also manages for a fee 450,000 rentable square feet on behalf of PS.

References to the number of properties, apartment units or square footage are unaudited and outside the scope of the Company’s independent registered public accounting firm's audit of the Company’s consolidated financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States).

2. Summary of significant accounting policies

Basis of presentation

The accompanying consolidated financial statements include the accounts of PSB and its subsidiaries, including the OP and our consolidated joint venture. All significant inter-company balances and transactions have been eliminated in the consolidated financial statements. The financial statements are presented on an accrual basis in accordance with U.S. generally accepted accounting principles (“GAAP”).

Consolidation and equity method of accounting

We consider entities to be Variable Interest Entities (“VIEs”) when they have insufficient equity to finance their activities without additional subordinated financial support provided by other parties, or the equity holders as a group do not have a controlling financial interest. A limited partnership is also generally considered a VIE if the limited partners do not participate in operating decisions. We consolidate VIEs when we are the primary beneficiary, generally defined as having (i) the power to direct the activities most significantly impacting economic performance and (ii) either the obligation to absorb losses or the right to receive benefits from the VIE.

We account for investments in entities that are not VIEs that we have significant influence over, but do not control, using the equity method of accounting and for investment in entities that we control, we consolidate. Prior to January 1, 2018, we had an interest in a joint venture engaged in the development and operation of residential real estate, which we accounted for using the equity method of accounting. On January 1, 2018, we began to consolidate the joint venture in our consolidated financial statements, due to changes to the joint venture agreement that gave the Company control of the joint venture. See Note 4 for more information on this entity.

PS, the sole limited partner in the OP, has no power to direct the activities of the OP. We are the primary beneficiary of the OP. Accordingly, we consider the OP a VIE and consolidate it. Substantially all of our assets and liabilities are held by the OP.

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Noncontrolling interests

Noncontrolling interests represent (i) PS's noncontrolling interest in the OP through its ownership of 7,305,355 common partnership units and (ii) a third-party 5.0% interest in our consolidated joint venture owning a 395-unit multifamily apartment complex. See Note 8 for further information on noncontrolling interests.

Use of estimates

The preparation of the consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from these estimates.

Allowance for doubtful accounts

The Company monitors the collectability of its receivable balances including the deferred rent receivable on an ongoing basis. Customer receivables are net of an allowance for estimated uncollectible accounts totaling \$400,000 at both December 31, 2018 and 2017. Deferred rent receivable is net of an allowance for uncollectible accounts totaling \$876,000 and \$867,000 at December 31, 2018 and 2017, respectively.

Financial instruments

The methods and assumptions used to estimate the fair value of financial instruments are described below. The Company has estimated the fair value of financial instruments using available market information and appropriate valuation methodologies. Considerable judgment is required in interpreting market data to develop estimates of market value. Accordingly, estimated fair values are not necessarily indicative of the amounts that could be realized in current market exchanges. The Company determines the estimated fair value of financial assets and liabilities utilizing a hierarchy of valuation techniques based on whether the inputs to a fair value measurement are considered to be observable or unobservable in a marketplace. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect market assumptions. This hierarchy requires the use of observable market data when available. The following is the fair value hierarchy:

- Level 1—quoted prices for identical instruments in active markets;

· 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—fair value measurements derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

Financial assets that are exposed to credit risk consist primarily of cash equivalents and receivables. The Company considers all highly liquid investments with a remaining maturity of three months or less at the date of purchase to be cash equivalents. Cash and cash equivalents, which consist primarily of money market investments, are only invested in entities with an investment grade rating. Receivables are comprised of balances due from various customers. Balances that the Company expects to become uncollectible are reserved for or written off. Due to the short period to maturity of the Company's cash and cash equivalents, accounts receivable, other assets and accrued and other liabilities, the carrying values as presented on the consolidated balance sheets are reasonable estimates of fair value.

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The following table provides a reconciliation of cash, cash equivalents and restricted cash per the consolidated statements of cash flow to the corresponding financial statement line items in the consolidated balance sheets as of December 31, 2018, 2017 and 2016 (in thousands):

	For The Years Ended December		
	31, 2018	2017	2016
Consolidated balance sheets			
Cash and cash equivalents	\$ 37,379	\$ 114,882	\$ 128,629
Restricted cash included in			
Land and building held for development	1,088	1,088	—
Consolidated statements of cash flows	\$ 38,467	\$ 115,970	\$ 128,629

During 2017, in conjunction with seeking entitlements to develop our multifamily projects in Tysons, Virginia, we contributed \$1.1 million into an escrow account for the future development of an athletic field.

Carrying values of the Company's unsecured Credit Facility (as defined below) approximate fair value. The characteristics of these financial instruments, market data and other comparative metrics utilized in determining these fair values are "Level 2" inputs.

Real estate facilities

Real estate facilities are recorded at cost. Property taxes, insurance, interest and costs essential to the development of property for its intended use are capitalized during the period of development. Direct costs related to the renovation or improvement of the properties are capitalized. Expenditures for repairs and maintenance are expensed as incurred. Expenditures that are expected to benefit a period greater than two years are capitalized and depreciated over their estimated useful life. Buildings and improvements are depreciated using the straight-line method over their estimated useful lives, which generally range from five to 30 years. Transaction costs, which include tenant improvements and lease commissions, for leases with terms greater than one year are capitalized and depreciated over their estimated useful lives.

Property held for sale or development

Real estate is classified as held for sale when the asset is being marketed for sale and we expect that a sale is likely to occur in the next 12 months. Real estate is classified as held for development when it is no longer used in its original form and likely that it will be developed to an alternate use. Property held for development or sale is not depreciated.

Intangible assets/liabilities

When we acquire real estate facilities, an intangible asset is recorded as other assets for leases where the in-place rent is higher than market rents, and an intangible liability is recorded as other liabilities where the market rents are higher than the in-place rents. The amounts recorded are based upon the present value (using a discount rate which reflects the risks associated with the leases acquired) of such differences over the lease term and such amounts are amortized to rental income over the respective remaining lease term. As of December 31, 2018, the value of above-market in-place rents resulted in net intangible assets of \$1.8 million, net of \$10.0 million of accumulated amortization and the value of below-market in-place rents resulted in net intangible liabilities of \$1.8 million, net of \$10.8 million of accumulated amortization. As of December 31, 2017, the value of above-market in-place rents resulted in net intangible assets of \$731,000, net of \$9.5 million of accumulated amortization and the value of below-market in-place rents resulted in net intangible liabilities of \$383,000, net of \$10.4 million of accumulated amortization.

Additionally, when we acquire real estate facilities, the value of in-place leases (i.e. customer lease-up costs) is recorded as other assets and is amortized to depreciation and amortization expense over the respective remaining lease term. As of December 31, 2018, the value of acquired in-place leases resulted in net intangible assets of \$4.7 million, net of \$1.3 million of accumulated amortization. As of December 31, 2017, we had no in-place lease intangibles on our consolidated balance sheet.

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Evaluation of asset impairment

We evaluate our real estate and finite-lived intangible assets for impairment each quarter. If there are indicators of impairment and we determine that the carrying value of the asset is not recoverable from estimated future undiscounted cash flows to be received through the asset's remaining life (or, if earlier, the expected disposal date), we record an impairment charge to the extent the carrying amount exceeds the asset's estimated fair value or net proceeds from expected disposal.

We evaluate our investment in our unconsolidated joint venture on a quarterly basis. We record an impairment charge to the extent the carrying amount exceeds estimated fair value, when we believe any such shortfall is other than temporary.

No impairment charges were recorded in any period presented herein.

Asset impairment due to casualty loss

It is our policy to record losses due to physical damages during the accounting period in which they occur, while the amount of monetary assets to be received from the insurance policy is recognized when receipt of insurance recoveries is probable. Losses, which are reduced by the related probable insurance recoveries, are recorded as costs of operations on the consolidated statements of income. Anticipated proceeds in excess of recognized losses would be considered a gain contingency and recognized when the contingency related to the insurance claim has been resolved. Anticipated recoveries for lost rental income due to property damages are also considered to be a gain contingency and recognized when the contingency related to the insurance claim has been resolved.

No material casualty losses were incurred in any period presented herein.

Stock compensation

Share-based payments to employees, including grants of employee stock options, are recognized as stock compensation in the Company's consolidated statements of income based on their grant date fair values, except for performance-based grants, which are accounted for based on their fair values at the beginning of the service period. See Note 11.

Accrued and other liabilities and other assets

Accrued and other liabilities consist primarily of rents prepaid by our customers, trade payables, property tax accruals, accrued payroll and contingent loss accruals when probable and estimable, as well as the intangible liabilities discussed above. We disclose the nature of significant unaccrued losses that are reasonably possible of occurring and, if estimable, a range of exposure.

Other assets are comprised primarily of prepaid expenses as well as the intangible assets discussed above.

We believe the fair value of our accrued and other liabilities and other assets approximate book value, due to the short period until settlement.

Revenue recognition

We recognize the aggregate rent to be collected (including the impact of escalators and concessions) under leases ratably throughout the non-cancellable lease term on a "Straight-Line" basis, commencing when the customer takes control of the leased space. Cumulative Straight-Line rent recognized in excess of amounts billed per the lease terms is presented as "deferred rent receivable" on our consolidated balance sheets. Reimbursements from customers for real estate taxes and other recoverable operating expenses are recognized as rental income in the period the applicable costs are incurred. Property management fees are recognized in the period earned as other income.

Costs incurred in acquiring customers (primarily tenant improvements and lease commissions) are capitalized and amortized over the lease period for leases with terms greater than one year.

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Sales of real estate facilities

Sales of real estate facilities are not part of our ordinary activities, and as a result, we consider such sales as contracts with non-customers. We recognize sales of real estate when we have collected payment and the attributes of ownership such as possession and control of the asset have been transferred to the buyer. If a contract for sale includes obligations to provide goods or services to the buyer, an allocated portion of the contract price is recognized as revenue as the related goods or services are transferred to the buyer.

General and administrative expenses

General and administrative expenses include executive and other compensation, corporate office expenses, professional fees, state income taxes and other such costs that are not directly related to the operation of our real estate facilities.

Income taxes

We have elected to be treated as a REIT, as defined in the Internal Revenue Code of 1986, as amended (the "Code"). As a REIT, we do not incur federal income tax if we distribute substantially all of our "REIT taxable income" each year, and if we meet certain organizational and operational rules. We believe we have met these REIT requirements for all periods presented herein. Accordingly, we have recorded no federal income tax expense related to our "REIT taxable income."

We recognize tax benefits of uncertain income tax positions that are subject to audit only if we believe it is more likely than not that the position would ultimately be sustained assuming the relevant taxing authorities had full knowledge of the relevant facts and circumstances of our positions. As of December 31, 2018 and 2017, we did not recognize any tax benefit for uncertain tax positions.

Accounting for preferred equity issuance costs

We record issuance costs as a reduction to paid-in capital on our consolidated balance sheets at the time the preferred securities are issued and reflect the carrying value of the preferred equity at its redemption value. An additional allocation of income is made from the common shareholders to the preferred shareholders in the amount of the original issuance costs, and we reclassify the redemption value from equity to liabilities when we call preferred shares

for redemption.

Net income per common share

Notwithstanding the presentation of income allocations on our consolidated statements of income, net income is allocated to (a) preferred shareholders, for distributions paid or payable, (b) preferred shareholders, to the extent redemption value exceeds the related carrying value (a "Preferred Redemption Allocation") and (c) restricted stock unit ("RSU") holders, for non-forfeitable dividends paid adjusted for participation rights in undistributed earnings. The remaining net income is allocated to the common partnership units and our common shareholders, respectively, based upon the pro-rata aggregate number of units and shares outstanding.

Basic and diluted net income per common share are each calculated based upon net income allocable to common shareholders, divided by (i) in the case of basic net income per common share, weighted average common shares and (ii) in the case of diluted income per share, weighted average common shares adjusted for the impact of stock compensation awards outstanding (Note 11) using the treasury stock method.

The following tables set forth the calculation of the components of our basic and diluted income per share that are not reflected on the face of our consolidated statements of income, including the allocation of income to common shareholders and common partnership units, the percentage of weighted average shares and common partnership units, as well as basic and diluted weighted average shares for the years ended December 31, (in thousands):

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	2018	2017	2016
Calculation of net income allocable to common shareholders			
Net income	\$ 271,901	\$ 179,316	\$ 144,984
Net (income) loss allocated to			
Preferred shareholders based upon distributions	(51,880)	(52,873)	(57,276)
Preferred shareholders based upon redemptions	—	(10,978)	(7,312)
Noncontrolling interests—joint venture	1,030	—	—
Restricted stock unit holders	(1,923)	(761)	(569)
Net income allocable to common shareholders and noncontrolling interests—common units	219,128	114,704	79,827
Net income allocation to noncontrolling interests—common units	(46,229)	(24,279)	(16,955)
Net income allocable to common shareholders	\$ 172,899	\$ 90,425	\$ 62,872
Calculation of common partnership units as a percentage of common share equivalents			
Weighted average common shares outstanding	27,321	27,207	27,089
Weighted average common partnership units outstanding	7,305	7,305	7,305
Total common share equivalents	34,626	34,512	34,394
Common partnership units as a percentage of common share equivalents	21.1%	21.2%	21.2%
Weighted average common shares outstanding			
Basic weighted average common shares outstanding	27,321	27,207	27,089
Net effect of dilutive stock compensation—based on treasury stock method using average market price	101	205	90
Diluted weighted average common shares outstanding	27,422	27,412	27,179

Segment reporting

The Company views its operations as one segment. We have two operating segments: (i) the acquisition, development, ownership and management of commercial real estate and (ii) the acquisition, development, ownership and management of multifamily real estate, but have one reportable segment as the multifamily segment does not meet the quantitative thresholds necessary to require reporting as a separate segment.

Reclassifications

Certain reclassifications have been made to the consolidated financial statements for 2016 in order to conform to the 2018 presentation, including reclassifying management fee income totaling \$518,000 for the year ended December 31, 2016 into “interest and other income” on our consolidated statements of income.

Recently issued accounting standards

In May 2014 and February 2016, the Financial Accounting Standards Board (“FASB”) issued two Accounting Standards Updates (“ASU”s), ASU 2014-09, Revenue from Contracts with Customers (the “Revenue Standard”), and ASU 2016-02, Leases (the “Lease Standard”). These standards apply to substantially all of our revenue generating activities, as well as provide a model to account for the disposition of real estate facilities to non-customers, which is governed under ASU 2017-05, Other Income - Gains and losses from the Derecognition of Nonfinancial Assets, clarifying the scope of asset derecognition guidance and accounting for partial sales of nonfinancial assets.

The Lease Standard will direct how we account for payments from the elements of our leases that are generally fixed and determinable at the inception of the lease (“Fixed Lease Payments”) while the Revenue Standard will direct how we account for the non-lease components of our lease contracts, primarily expense reimbursements (“Non-Lease Payments”).

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The adoption of the Revenue Standard and its impact on our accounting for the disposition of real estate facilities is described below.

The Lease Standard requires us to identify Fixed Lease Payments and Non-Lease Payments of a lease agreement and will govern the recognition of revenue for the Fixed Lease Payments. Revenue related to Non-Lease Payments under our lease arrangements will be subject to the Revenue Standard effective upon adoption of the Lease Standard. See further discussion below on Fixed Lease Payments and Non-Lease Payments.

Under the Lease Standard, a set of practical expedients for implementation, which must be elected as a package and for all leases, may be elected. These practical expedients include (i) relief from re-assessing whether an expired or existing contract meets the definition of a lease, (ii) relief from re-assessing the classification of expired or existing leases at the adoption date and (iii) allowing previously capitalized initial direct leasing costs to continue to be amortized. We elected the practical expedient package upon adoption of the Lease Standard on January 1, 2019.

We implemented the Lease Standard on its effective date of January 1, 2019 using the required modified retrospective transition approach (with certain transition relief that is available to us). The modified retrospective approach will require us to first record an adjustment to the January 1, 2017 balance of accumulated earnings (deficit) for the cumulative impact of the Lease Standard on all leases existing at January 1, 2017. Then, we will have to restate the financial statements for the years ended December 31, 2017 and 2018 for the Lease Standard impact on all leases that were in force at any time during those periods. In July, 2018, the FASB issued an amendment to the transition method that allows adoption on January 1, 2019 with a cumulative effect adjustment as of January 1, 2019, with no restatement of prior periods. We elected this transition method upon adoption of the Lease Standard on January 1, 2019.

Lessor Accounting

We recognized revenue from our lease arrangements aggregating \$413.5 million for the year ended December 31, 2018. This revenue consisted primarily of rental income and expense reimbursements of \$322.3 million and \$91.2 million, respectively.

Under the accounting standards in effect prior to January 1, 2019, we are required to account for Fixed Lease Payments on a straight-line basis, with the expected fixed payments recognized ratably over the term of the lease. Payments for expense reimbursements received under these lease arrangements related to our customer's pro rata share of real estate taxes, insurance, utilities, repairs and maintenance, common area expense and other operating expenses are considered Fixed Lease Payments. We recognize these reimbursements as revenue when the related contractually recoverable operating expenses are incurred.

Under the Lease Standard, the total consideration in each lease agreement will be allocated to the Fixed Lease Payment and Non-Lease Payments based on their relative standalone selling prices. Lessors will continue to recognize the Fixed Lease Payments on a straight-line basis, which is consistent with existing guidance for operating leases. The issued amendment to the Lease Standard noted above also allows lessors to elect, as a practical expedient, not to allocate the total consideration to Fixed Lease Payments and Non-Lease Payments based on their relative standalone selling prices. This practical expedient allows lessors to elect a combined single component presentation if (i) the timing and pattern of the revenue recognition for the Fixed Lease Payments and Non-Lease Payments are the same, and (ii) the combined single component of the lease would continue to be classified as an operating lease.

We do not expect that the Lease Standard will impact our accounting for Fixed Lease Payments, because our accounting policy is currently consistent with the provisions of the standard. Upon adoption of the Lease Standard, we expect to adopt the practical expedient, specifically related to payments for expense reimbursements that qualify as Non-Lease Payments to be presented under a single lease component presentation, which would otherwise be accounted for under the Revenue Standard. We believe the two conditions have been met for Non-Lease Payments as (i) the timing and pattern of transfer of the Fixed Lease Payments and Non-Lease Payments are the same, and (ii) the combined single component of the lease would be classified as an operating lease.

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Costs to execute leases

The Lease Standard also provides updated guidance on the requirements for the capitalization of the incremental costs incurred in executing leases, such as legal fees and commissions. Under the Lease Standard, any costs that would have been incurred regardless of successful lease execution, such as allocated costs of internal personnel, are to be expensed and may not be capitalized. As we do not currently capitalize any such costs, we do not expect this component of the Lease Standard to have a material effect to our consolidated financial statements.

Lessee accounting

Under the Lease Standard, lessees are required to apply a dual approach by classifying leases as either finance or operating leases based on the principle whether the lease is effectively a finance purchase of the leased asset by the lessee. This classification will determine whether the lease expense is recognized based on an effective interest method or a straight-line basis over the term of the lease. For most leases with a term of greater than 12 months, in which we are the lessee, the present value of future lease payments will be recognized on our balance sheet as a right-of-use asset and related liability. We do not expect a material impact to our consolidated financial statements from the initial recognition of each lease liability upon the adoption, nor from the pattern of recognition subsequent to adoption.

The Revenue Standard

In May, 2014, the FASB issued the Revenue Standard on recognition of revenue arising from contracts with customers, as well as the accounting for the disposition of real estate facilities, and subsequently, issued additional guidance that further clarified the standard. Rental income from leasing arrangements is a substantial portion of our revenues and is specifically excluded from the Revenue Standard and will be governed by the Lease Standard (discussed above).

The core principle underlying this guidance is that entities will recognize revenue upon the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled for such exchange.

The Revenue Standard permits either the full retrospective or modified retrospective transition method. We adopted the Revenue Standard effective January 1, 2018 utilizing the modified retrospective transition method applied to contracts not completed as of January 1, 2018 and the adoption did not result in a material impact to our consolidated financial statements.

Revenue within the scope of the Revenue Standard

Sales of Real Estate Facilities

Under the Revenue Standard, which includes guidance on recognition of gains and losses arising from the derecognition of nonfinancial assets in a transaction with non-customers, the derecognition model is based on the transfer of control of nonfinancial assets or in substance nonfinancial assets that do not meet the definition of a business. Generally, our sales of real estate facilities would be considered a sale of a nonfinancial asset to non-customers. If we determine we do not have a controlling financial interest in the entity that holds the asset and the arrangement meets the criteria to be accounted for as a contract, we would derecognize the asset and recognize a gain or loss on the sale of the real estate facilities accounted under the revenue recognition principles under the Revenue Standard.

The adoption of the Revenue Standard had no material impact on the recognition of \$93.5 million in gain on sale of real estate facilities during the year ended December 31, 2018.

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3. Real estate facilities

The activity in real estate facilities for the years ended December 31, 2018, 2017 and 2016 is as follows (in thousands):

	Land	Buildings and Improvements	Accumulated Depreciation	Total
Balances at December 31, 2015	\$ 773,074	\$ 2,109,097	\$ (1,010,197)	\$ 1,871,974
Acquisition of real estate facilities	5,638	7,637	—	13,275
Capital expenditures	—	37,232	—	37,232
Disposals (1)	—	(14,411)	14,411	—
Depreciation and amortization expense	—	—	(99,486)	(99,486)
Transfer to land and building held for development	(9,676)	(19,092)	7,870	(20,898)
Transfer to properties held for sale	—	(1,251)	3,316	2,065
Balances at December 31, 2016	769,036	2,119,212	(1,084,086)	1,804,162
Capital expenditures	—	51,909	—	51,909
Disposals (1)	—	(13,919)	13,919	—
Depreciation and amortization expense	—	—	(94,270)	(94,270)
Transfer to properties held for sale	—	(340)	2,639	2,299
Balances at December 31, 2017 (2)	769,036	2,156,862	(1,161,798)	1,764,100
Acquisition of real estate facility	25,806	112,230	—	138,036
Consolidation of joint venture	21,814	84,903	—	106,717
Capital expenditures	—	38,904	—	38,904
Disposals (1)	—	(17,345)	17,345	—
Depreciation and amortization expense	—	—	(96,732)	(96,732)
Transfer to properties held for sale	—	(611)	69	(542)
Balances at December 31, 2018	\$ 816,656	\$ 2,374,943	\$ (1,241,116)	\$ 1,950,483

(1) Disposals primarily represent the book value of tenant improvements that have been removed upon the customer vacating their space.

(2) We reclassified seven multi-tenant flex buildings totaling 194,000 square feet located in Dallas, Texas, as properties held for sale as of December 31, 2017.

The unaudited December 31, 2018 net federal tax basis of real estate facilities was approximately \$1.9 billion.

As of December 31, 2018, we have commitments, pursuant to executed leases throughout our portfolio, to spend \$9.8 million on transaction costs, which include tenant improvements and lease commissions.

The purchase price of acquired properties is allocated to land, buildings and improvements (including tenant improvements, unamortized lease commissions, acquired in-place lease values and customer relationships, if any), intangible assets and intangible liabilities (see Note 2), based upon the relative fair value of each component, which are evaluated independently.

We must make significant assumptions in determining the fair value of assets acquired and liabilities assumed, which can affect the recognition and timing of revenue and depreciation and amortization expense. The fair value of land is estimated based upon, among other considerations, comparable sales of land within the same region. The fair value of buildings and improvements, tenant improvements and unamortized lease commissions are based on current market replacement costs and other available market information. The amount recorded to acquired in-place leases is determined based on management's assessment of current market conditions and the estimated lease-up periods for the respective spaces.

Effective January 1, 2017, transaction costs related to asset acquisitions are capitalized as part of the purchase price. Prior to 2017, such costs related to asset acquisitions were expensed as incurred.

On June 8, 2018, we acquired two multi-tenant industrial parks aggregating 1.1 million rentable square feet in Springfield, Virginia, for a net purchase price of \$143.8 million.

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On September 28, 2016, we acquired two multi-tenant office buildings aggregating 226,000 square feet in Rockville, Maryland, for a purchase price of \$13.3 million. We incurred and expensed related acquisition transaction costs of \$328,000 for the year ended December 31, 2016.

We did not acquire any properties during the year ended December 31, 2017.

The following table summarizes the assets acquired and liabilities assumed for the years ended December 31, (in thousands):

	2018	2017	2016
Land	\$ 25,806	\$ —	\$ 5,638
Buildings and improvements	112,230	—	7,637
Other assets (above-market in-place rents)	1,487	—	—
Accrued and other liabilities (below-market in-place rents)	(1,790)	—	(25)
Other assets (in-place lease value)	6,033	—	—
Total purchase price	143,766	—	13,250
Net operating assets acquired and liabilities assumed	(1,367)	—	(622)
Total cash paid	\$ 142,399	\$ —	\$ 12,628

The following table summarizes the assets acquired and liabilities assumed related to the consolidation of the joint venture, which was accounted for as an asset acquisition, as of January 1, 2018 (see Note 4 below) (in thousands):

Land	\$ 21,814
Buildings and improvements	84,903
Other assets (in-place lease value)	1,199
Total consolidated joint venture	107,916
Noncontrolling interest in consolidated joint venture	(4,032)
Net book value of joint venture at consolidation	\$ 103,884

On March 31, 2017, we sold development rights we held to build medical office buildings on land adjacent to our Westech Business Park in Silver Spring, Maryland for \$6.5 million. We received net sale proceeds of \$6.4 million, of which \$1.5 million was received in prior years and \$4.9 million was received in 2017. We recorded a net gain of \$6.4 million for the year ended December 31, 2017.

Properties Sold

In 2017 and 2018, we entered into a plan to sell four of our properties. We determined that the sale did not meet the criteria for discontinued operations presentation as the plan to sell did not represent a strategic shift that will have a major effect on our operations and financial results. As a result of this classification, the assets of the properties are separately presented as held for sale in the consolidated balance sheet as of December 31, 2017.

On March 5, 2018, we sold Corporate Pointe Business Park, a park consisting of five multi-tenant office buildings totaling 161,000 square feet located in Orange County, California, for net sale proceeds of \$41.7 million, which resulted in a gain of \$26.8 million. On April 18, 2018, we sold Orange County Business Center, a park consisting of five multi-tenant office buildings totaling 437,000 square feet located in Orange County, California, for net sale proceeds of \$73.3 million, which resulted in a gain of \$50.6 million. On April 30, 2018, we sold Northgate Business Park, a park consisting of seven multi-tenant flex buildings totaling 194,000 square feet located in Dallas, Texas, for net sale proceeds of \$11.8 million, which resulted in a gain of \$7.9 million. On October 31, 2018, we sold Orangewood Office Park, a park consisting of two multi-tenant office buildings totaling 107,000 square feet located in Orange County, California, for net sale proceeds of \$18.3 million, which resulted in a gain of \$8.2 million.

Each of the facilities sold during the year ended December 31, 2018 were included in “properties held for sale, net” as of December 31, 2017.

On May 1, 2017, we sold Empire Commerce, a two-building single-story office park comprising 44,000 square feet, located in Dallas, Texas, for net sale proceeds of \$2.1 million, which resulted in a net gain of \$1.2 million.

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As of November 1, 2016, we transferred a 123,000 square foot vacant office building located within The Mile that we are seeking to demolish in order to construct a multifamily apartment complex on the parcel. This parcel is reflected on our consolidated balance sheets as land and building held for development. The scope and timing of development of this site is subject to a variety of contingencies, including approval of entitlement. Prior to being classified as land and building held for development, the building was occupied by a single customer.

4. Investment in and advances to unconsolidated joint venture

In 2013, the Company entered into a joint venture known as Amherst JV LLC with an unrelated real estate development company (the “JV Partner”) for the purpose of developing a 395-unit multifamily building on a five-acre site (the “Project”) within the Company’s 628,000 square foot office park located in Tysons, Virginia (known as “The Mile”). We hold a 95.0% interest in the joint venture with the remaining 5.0% held by the JV Partner. The JV Partner was responsible for the development and construction of the Project, and has been and continues to be responsible for the leasing and operational management of the Project. Prior to January 1, 2018, we did not control the joint venture, when considering, among other factors, that the consent of the JV Partner was required for all significant decisions. Accordingly, we previously accounted for our investment using the equity method. On January 1, 2018, we began to consolidate the joint venture due to changes to the joint venture agreement that gave the Company control of the joint venture.

On October 5, 2015, we contributed the site and improvements to the joint venture. We also provided the joint venture with a construction loan in the amount of \$75.0 million bearing interest at the London Interbank Offered Rate (“LIBOR”) plus 2.25%. The loan will mature on April 5, 2019 with two one-year extension options. Based on the consolidation of the joint venture, the construction loan to the joint venture has been eliminated in our consolidated financial statements.

The aggregate amount of development costs were \$107.0 million, which included our net book value of contributed land plus entitlement costs but excluded unrealized land appreciation. The Project delivered its first completed units in May, 2017, and was substantially completed during the fourth quarter of 2017.

At December 31, 2017, we reflected the aggregate cost of the contributed site and improvements, our equity contributions and loan advances, as well as capitalized third party interest we incurred as investment in and advances to unconsolidated joint venture. The Company’s investment in and advances to unconsolidated joint venture was \$100.9 million at December 31, 2017. For the year ended December 31, 2017, we made loan advances of \$34.1 million and capitalized \$506,000 of interest. For the year ended December 31, 2016, we made loan advances of \$33.9 million, capital contributions of \$5.7 million and capitalized \$885,000 of interest.

During the year ended December 31, 2017, the Company recorded an equity loss in the unconsolidated joint venture of \$805,000, comprised of net operating income of \$375,000 and depreciation expense of \$1.2 million.

5. Leasing activity

The Company leases space in its commercial real estate facilities to customers primarily under non-cancelable leases generally ranging from one to 10 years. Future minimum rental income, excluding recovery of operating expenses under these leases, is as follows as of December 31, 2018 (in thousands):

2019	\$ 289,220
2020	223,015
2021	164,039
2022	111,253
2023	73,019
Thereafter	112,059
Total	\$ 972,605

In addition to minimum rental payments, certain customers reimburse the Company for their pro rata share of specified property operating expenses. Such reimbursements amounted to \$91.2 million, \$90.8 million and \$82.6 million for the years ended December 31, 2018, 2017 and 2016, respectively. These amounts are included as rental income in the accompanying consolidated statements of income.

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Leases accounting for 3.0% of total leased square footage are subject to termination options, of which 1.3% of total leased square footage have termination options exercisable through December 31, 2019 (unaudited). In general, these leases provide for termination payments to us should the termination options be exercised. The future minimum rental income in the above table assumes such options are not exercised.

6. Bank loans

We have a revolving line of credit (the “Credit Facility”) with Wells Fargo Bank, National Association (“Wells Fargo”). The Credit Facility has a borrowing limit of \$250.0 million and expires January 10, 2022. The rate of interest charged on borrowings is based on LIBOR plus 0.80% to LIBOR plus 1.55% depending on the Company’s credit ratings. Currently, the Company’s rate under the Credit Facility is LIBOR plus 0.825%. In addition, the Company is required to pay an annual facility fee ranging from 0.10% to 0.30% of the borrowing limit depending on the Company’s credit ratings (currently 0.125%). We had no balance outstanding on our Credit Facility at December 31, 2018 and 2017. We paid \$613,000 of loan origination costs in January, 2017. The Company had \$691,000 and \$921,000 of total unamortized loan origination costs as of December 31, 2018 and 2017, respectively, which is included in other assets in the accompanying consolidated balance sheets. The Credit Facility requires us to meet certain covenants, all of which we were in compliance with at December 31, 2018. Interest on outstanding borrowings is payable monthly.

7. Mortgage note payable

On June 1, 2016, the Company repaid in full a \$250.0 million mortgage note which had a fixed interest rate of 5.45%.

8. Noncontrolling interests

Noncontrolling interests represent (i) PS’s noncontrolling interest in the OP through its ownership of 7,305,355 common partnership units, totaling \$215.1 million and \$196.6 million at December 31, 2018 and 2017, respectively, and (ii) the JV Partner’s 5.0% interest in a joint venture owning a 395-unit multifamily apartment complex, totaling \$3.0 million and none at December 31, 2018 and 2017, respectively.

PS OP Interests

Each common partnership unit receives a cash distribution equal to the dividend paid on our common shares and is redeemable at PS's option.

If PS exercises its right of redemption, at PSB's option (a) PS will receive one common share from us for each common partnership unit redeemed, or (b) PS will receive cash from us for each common partnership unit generally equal to the market value of a common share (as defined in the Operating Partnership Agreement). We can prevent redemptions that we believe would violate either our articles of incorporation or securities laws, cause PSB to no longer qualify as a REIT, or could result in the OP no longer being treated as a partnership for federal tax purposes.

In allocating net income and presenting equity, we treat the common partnership units as if converted to common shares. Accordingly, they receive the same net income allocation per unit as a common share and are adjusted each period to have the same equity per unit as a common share, totaling \$46.2 million, \$24.3 million and \$17.0 million for the years ended December 31, 2018, 2017 and 2016, respectively.

JV Partner

In conjunction with consolidating the joint venture on January 1, 2018, we recorded noncontrolling interest of \$4.0 million related to the JV Partner's 5.0% interest in a joint venture owning a 395-unit multifamily apartment complex. A total of \$1.0 million in loss was allocated to the JV Partner during year ended December 31, 2018 and no distributions were paid to the JV Partner.

9. Related party transactions

We manage certain industrial, office and retail facilities in the United States for PS under either the "Public Storage" or "PS Business Parks" names (the "PS Management Agreement"). Under PS's supervision, we coordinate and assist in rental

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and marketing activities, property maintenance and other operational activities, including the selection of vendors, suppliers, employees and independent contractors. We receive a management fee based upon a percentage of revenues, which is included in “interest and other income” on our consolidated statements of income. Management fee revenues were \$407,000, \$506,000 and \$518,000 for the years ended December 31, 2018, 2017 and 2016, respectively. We allocate certain operating expenses to PS related to the management of these properties, including payroll and other business expenses, totaling \$472,000, \$537,000 and \$554,000 for the years ended December 31, 2018, 2017 and 2016, respectively.

The PS Business Parks name and logo are owned by PS and licensed to us under a non-exclusive, royalty-free license agreement. The license can be terminated by either party for any reason with six months written notice.

PS provides us property management services for the self-storage component of two assets we own and operates them under the “Public Storage” name. Either the Company or PS can cancel the property management contract upon 60 days’ notice. Under our supervision, PS coordinates and assists in rental and marketing activities, and property maintenance and other operational activities, including the selection of vendors, suppliers, employees and independent contractors. Management fee expenses were \$96,000, \$92,000 and \$86,000 for the years ended December 31, 2018, 2017 and 2016, respectively. Additionally, PS allocated certain operating expenses to us related to the management of these properties totaling \$65,000, \$61,000 and \$61,000 for the three years ended December 31, 2018, 2017 and 2016, respectively. These amounts are included under “cost of operations” on our consolidated statements of income.

Pursuant to a cost sharing agreement, we share certain administrative services, corporate office space, and certain other third party costs with PS which are allocated based upon fair and reasonable estimates of the cost of the services expected to be provided. We reimbursed PS \$1.2 million, \$1.3 million and \$1.1 million, respectively, for costs PS incurred on our behalf for the years ended December 31, 2018, 2017 and 2016. PS reimbursed us \$38,000, \$31,000 and \$38,000 costs we incurred on their behalf for the years ended December 31, 2018, 2017 and 2016, respectively.

The Company had net amounts due from PS of \$43,000 at December 31, 2018 and due to PS of \$245,000 at December 31, 2017 for these contracts, as well as for certain operating expenses paid by the Company on behalf of PS.

10. Shareholders’ equity

Preferred stock

As of December 31, 2018 and 2017, the Company had the following series of preferred stock outstanding:

Series	Issuance Date	Earliest Potential Redemption Date	Dividend Rate	Shares Outstanding	Amount (in thousands)
Series U	September, 2012	September, 2017	5.75%	9,200	\$ 230,000
Series V	March, 2013	March, 2018	5.70%	4,400	110,000
Series W	October, 2016	October, 2021	5.20%	7,590	189,750
Series X	September, 2017	September, 2022	5.25%	9,200	230,000
Series Y	December, 2017	December, 2022	5.20%	8,000	200,000
Total				38,390	\$ 959,750

On January 3, 2018, we completed the redemption of our remaining 6.00% Cumulative Preferred Stock, Series T, at par of \$130.0 million. We recorded a Preferred Redemption Allocation of \$4.1 million in the three months ended December 31, 2017 and reclassified the shares from equity to “preferred stock called for redemption” on our consolidated balance sheets at December 31, 2017.

On December 7, 2017, we issued \$200.0 million or 8,000,000 depository shares representing interests in our 5.20% Cumulative Preferred Stock, Series Y, at \$25.00 per depository share. The 5.20% Series Y Cumulative Redeemable Preferred Units are non-callable for five years and have no mandatory redemption. We received \$193.6 million in net proceeds.

On October 30, 2017, we completed a partial redemption of 8,800,000 of our outstanding 14,000,000 depository shares representing interests in our 6.0% Cumulative Preferred Stock, Series T, at par of \$220.0 million. We recorded a Preferred Redemption Allocation of \$6.9 million for the year ended December 31, 2017.

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On September 21, 2017, we issued \$230.0 million or 9,200,000 depositary shares representing interests in our 5.25% Cumulative Preferred Stock, Series X, at \$25.00 per depositary share. The 5.25% Series X Cumulative Redeemable Preferred Units are non-callable for five years and have no mandatory redemption. We received \$222.2 million in net proceeds.

On December 7, 2016, we called our 6.45% Cumulative Preferred Stock, Series S, for redemption at par and completed the redemption on January 18, 2017. We recorded a Preferred Redemption Allocation of \$7.3 million in the three months ended December 31, 2016 and reclassified the shares from equity to “preferred stock called for redemption” on our consolidated balance sheets at December 31, 2016.

On October 20, 2016, we issued \$189.8 million or 7,590,000 depositary shares representing interests in our 5.20% Cumulative Preferred Stock, Series W, at \$25.00 per depositary share. The 5.20% Series W Cumulative Redeemable Preferred Units are non-callable for five years and have no mandatory redemption. We received \$183.3 million in net proceeds.

We paid \$52.6 million, \$52.2 million and \$57.3 million in distributions to our preferred shareholders for the years ended December 31, 2018, 2017 and 2016, respectively.

The holders of our preferred stock have general preference rights with respect to liquidation, quarterly distributions and any accumulated unpaid distributions. Holders of our preferred stock will not be entitled to vote on most matters, except under certain conditions. In the event of a cumulative arrearage equal to six quarterly dividends, the holders of the preferred stock will have the right to elect two additional members to serve on the Company’s Board of Directors (the “Board”) until all events of default have been cured. At December 31, 2018, there were no dividends in arrears.

Except under certain conditions relating to the Company’s qualification as a REIT, the preferred stock is not redeemable prior to the redemption dates noted above. On or after the respective redemption dates, the respective series of preferred stock will be redeemable, at the option of the Company, in whole or in part, at \$25.00 per depositary share, plus any accrued and unpaid dividends.

Common stock and units

We paid \$103.8 million (\$3.80 per common share), \$92.5 million (\$3.40 per common share) and \$81.3 million (\$3.00 per common share) in distributions to our common shareholders for the years ended December 31, 2018, 2017 and 2016, respectively. We paid \$27.8 million (\$3.80 per common share), \$24.8 million (\$3.40 per common share), and \$21.9 million (\$3.00 per common share) in distributions to our common unit holders for the years ended December

31, 2018, 2017 and 2016, respectively.

The portion of the distributions classified as ordinary income was 99.3%, 95.9% and 100.0% for the years ended December 31, 2018, 2017 and 2016, respectively. The portion of the distributions classified as long-term capital gain income was 0.7%, 4.1% and 0.0% for the years ended December 31, 2018, 2017 and 2016, respectively. The percentages in the two preceding sentences are unaudited.

During the three months ended June 30, 2018, the Board increased our quarterly dividend from \$0.85 per common share to \$1.05 per common share. During the three months ended March 31, 2017, the Board increased our quarterly dividend from \$0.75 per common share to \$0.85 per common share. During the three months ended March 31, 2016, the Board increased our quarterly dividend from \$0.60 per common share to \$0.75 per common share.

Equity stock

The Company is authorized to issue 100.0 million shares of Equity Stock. The Articles of Incorporation provide that Equity Stock may be issued from time to time in one or more series and give the Board broad authority to fix the dividend and distribution rights, conversion and voting rights, redemption provisions and liquidation rights of each series of Equity Stock. As of December 31, 2018 and 2017, no equity stock had been issued.

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11. Stock compensation

Under various share-based compensation plans, PSB grants non-qualified options to purchase the Company's common shares at a price not less than fair value on the date of grant, as well as RSUs, to certain directors, officers and key employees.

The service period for stock options and RSUs begins when (i) the Company and the recipient reach a mutual understanding of the key terms of the award, (ii) the award has been authorized, (iii) the recipient is affected by changes in the market price of our stock and (iv) it is probable that any performance conditions will be met, and ends when the stock option or RSUs vests.

We account for forfeitures of share-based payments as they occur by reversing previously amortized share-based compensation expense with respect to grants that are forfeited in the period the employee terminates employment. We recorded a cumulative-effect adjustment of \$807,000 to decrease accumulated earnings (deficit) and increase paid-in capital representing the impact of estimated forfeitures on our cumulative share-based compensation expense recorded through September 30, 2016.

We amortize the fair value of awards starting at the beginning of the service period as compensation expense. For awards that are earned solely upon the passage of time and continued service, the entire cost of the award is amortized on a straight-line basis over the service period. For awards with performance conditions, the individual cost of each vesting is amortized separately over each individual service period (the "accelerated attribution" method).

Stock Options

Stock options expire 10 years after the grant date and the exercise price is equal to the closing trading price of our common shares on the grant date. Employees cannot require the Company to settle their award in cash. We use the Black-Scholes option valuation model to estimate the fair value of our stock options on the date of grant.

	2018	2017	2016
Stock option expense for the year (in 000's)	\$ 236	\$ 209	\$ 282
Aggregate exercise date intrinsic value of options exercised during the year (in 000's)	\$ 2,752	\$ 5,177	\$ 3,416

Average assumptions used in valuing options with the Black-Scholes method:

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Expected life of options in years, based upon historical experience	5	5	5
Risk-free interest rate	2.8%	1.9%	1.1%
Expected volatility, based upon historical volatility	20.8%	17.5%	15.5%
Expected dividend yield	2.9%	2.8%	2.9%
Average estimated value of options granted during the year	\$ 18.11	\$ 14.42	\$ 9.05

As of December 31, 2018, there was \$604,000 of unamortized compensation expense related to stock options expected to be recognized over a weighted average period of 3.3 years.

Cash received from 44,994 stock options exercised during the year ended December 31, 2018 was \$3.0 million. Cash received from 73,246 stock options exercised during the year ended December 31, 2017 was \$4.2 million. Cash received from 68,019 stock options exercised during the year ended December 31, 2016 was \$3.9 million.

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Information with respect to stock options during 2018, 2017 and 2016 is as follows:

Options:	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contract Life	Aggregate Intrinsic Value (in thousands)
Outstanding at December 31, 2015	258,674	\$ 60.76		
Granted	39,000	\$ 102.58		
Exercised	(68,019)	\$ 57.17		
Forfeited	—	\$ —		
Outstanding at December 31, 2016	229,655	\$ 68.93		
Granted	16,000	\$ 121.57		
Exercised	(73,246)	\$ 57.59		
Forfeited	—	\$ —		
Outstanding at December 31, 2017	172,409	\$ 78.63		
Granted	16,000	\$ 115.45		
Exercised	(44,994)	\$ 66.88		
Forfeited	—	\$ —		
Outstanding at December 31, 2018	143,415	\$ 86.42	5.63 Years	\$ 6,393
Exercisable at December 31, 2018	82,815	\$ 71.36	3.95 Years	\$ 4,939

RSUs

RSUs granted prior to 2016 are subject to a six-year vesting, with 20% vesting after year two, and 20% vesting after each of the next four years. RSUs granted during and subsequent to 2016 are subject to a five-year vesting at the rate of 20% per year. The grantee receives dividends for each outstanding RSU equal to the per share dividend received by common shareholders. We expense any dividends previously paid upon forfeiture of the related RSU. Upon vesting, the grantee receives common shares equal to the number of vested RSUs, less common shares withheld in exchange for tax withholdings made by the Company to satisfy the grantee's statutory tax liabilities arising from the vesting. The fair value of our RSUs is determined based upon the applicable closing trading price of our common shares on the date of grant.

Effective March, 2014, the Company entered into a performance-based RSU program, the Senior Management Long-Term Equity Incentive Program for 2014-2017 ("LTEIP"), with certain employees of the Company. Under the LTEIP, the Company established three levels of targeted RSU awards, which would be earned only if the Company achieved one of three defined targets during 2014 to 2017. Under the LTEIP there was an annual award following the end of each of the four years in the program, with the award subject to and based on the achievement of total return targets during the previous year, as well as an award based on achieving total return targets during the cumulative four-year period 2014-2017. In the event the minimum defined target was not achieved for an annual award, the RSUs allocated to be awarded for such year were added to the RSUs that may be received if the four-year target was achieved. All RSU awards under the LTEIP vest in four equal annual installments beginning from the date of award.

Compensation expense is recognized based on the RSUs expected to be awarded based on the target level that is expected to be achieved. The compensation expense and RSU counts with respect to the LTEIP are included in the aggregate RSU amounts disclosed above. Senior management earned 145,350 RSUs granted in March, 2018 as the maximum targets were achieved for both the year ended December 31, 2017 and for the cumulative four-year period.

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Information with respect to RSUs during 2018, 2017 and 2016 is as follows (dollar amounts in thousands):

Restricted Stock Units:	Number of Units	Weighted Average Grant Date Fair Value
Nonvested at December 31, 2015	78,652	\$ 6,170
Granted	119,950	10,489
Vested	(47,779)	(3,844)
Forfeited	(6,130)	(469)
Nonvested at December 31, 2016	144,693	12,346
Granted	113,750	10,748
Vested	(76,994)	(6,597)
Forfeited	(16,366)	(1,381)
Nonvested at December 31, 2017	165,083	15,116
Granted	194,450	18,431
Vested	(106,103)	(9,256)
Forfeited	(10,140)	(905)
Nonvested at December 31, 2018	243,290	\$ 23,386

As of December 31, 2018, there was \$9.3 million of unamortized compensation expense related to RSUs expected to be recognized over a weighted average period of 3.6 years.

(In thousands, except number of shares)	2018	2017	2016
Restricted share unit expense	\$ 3,727	\$ 4,279	\$ 10,290
Common shares issued upon vesting	62,500	43,223	28,046
Fair value of vested shares on vesting date	\$ 12,127	\$ 8,816	\$ 4,699
Cash paid for taxes in lieu of shares upon vesting of RSUs	\$ 4,981	\$ 3,865	\$ 1,940

12. Supplementary quarterly financial data (unaudited, in thousands, except per share data):

	Three Months Ended			
	March 31, 2018	June 30, 2018	September 30, 2018	December 31, 2018
Rental income	\$ 103,759	\$ 101,824	\$ 103,808	\$ 104,125

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Cost of operations	\$ 33,000	\$ 31,256	\$ 31,654	\$ 30,637
Net income allocable to common shareholders	\$ 46,048	\$ 70,221	\$ 25,131	\$ 31,499
Net income per share				
Basic	\$ 1.69	\$ 2.57	\$ 0.92	\$ 1.15
Diluted	\$ 1.69	\$ 2.56	\$ 0.92	\$ 1.15