COUSINS PROPERTIES INC
Form 10-K/A
March 24, 2005

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**
**Washington, D.C. 20549**

**FORM 10-K/A**

(Amendment No.1)

(Mark One)

| | |
|---|---|
| þ | **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934** |

For the year ended December 31, 2003

or

| | |
|---|---|
| o | **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 0-3576

**COUSINS PROPERTIES INCORPORATED**

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| **Georgia**<br>(State or other jurisdiction of incorporation or organization) | **58-0869052**<br>(I.R.S. Employer Identification No.) |
| **2500 Windy Ridge Parkway, Suite 1600, Atlanta, Georgia**<br>(Address of principal executive offices) | **30339-5683**<br>(Zip Code) |

**(770) 955-2200**
(Registrant s telephone number, including area code)

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

| Title of each class | Name of Exchange on which registered |
|---|---|
| Common Stock ($1 par value) | New York Stock Exchange |
| 7.75% Series A Cumulative Redeemable Preferred Stock ($25 liquidation value) | New York Stock Exchange |

Securities registered pursuant to Section 12(g) of the Act: None

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 þ No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of 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. o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes þ No o

As of June 30, 2003, the aggregate market value of the common stock of Cousins Properties Incorporated held by non-affiliates was $1,008,688,788. As of February 24, 2004, 48,935,790 shares of common stock were outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Registrant s proxy statement for the annual stockholders meeting to be held on May 4, 2004 are incorporated by reference into Part III of this Form 10-K.

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Cousins Properties Incorporated
Form 10-K/A (Amendment No. 1)
For the Year Ended December 31, 2003

Explanatory Note

This Form 10-K/A is being filed to reflect the restatement for the consolidated statements of cash flows as discussed in Note 10 to the Consolidated Financial Statements. Historically, Cousins Properties Incorporated ( the Company ), presented the cash flows used in the acquisition and development of land that is subsequently subdivided and sold as investing activities. The Company changed its classification of these cash flows to operating activities as the land is acquired and developed primarily for sale to third parties. As a result, the Company has restated its consolidated statements of cash flows for the years ended December 31, 2003, 2002 and 2001 in this Form 10-K/A (Amendment No. 1), revised its discussion within Management s Discussion and Analysis in Item 7 of this report, and revised its discussion within Item 9A of this report. This change does not affect the Company s consolidated balance sheets, consolidated statements of income, or net changes in cash and cash equivalents for any of the periods presented.

On November 9, 2004, the Company filed a Current Report on Form 8-K that revised its Consolidated Financial Statements, Management s Discussion and Analysis and Results of Operations and Selected Financial Data, which appeared in its Annual Report on Form 10-K for the year ended December 31, 2003 originally filed on March 12, 2004. In its revised financial statements, the Company reclassified income and expenses associated with properties considered held for sale into a single line item, discontinued operations, on the consolidated statements of income for all periods presented, in accordance with Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. In this Annual Report on Form 10-K/A (Amendment No. 1), the Company has reclassified the income and expenses associated with properties held for sale consistent with the presentation in the Form 8-K referred to above.

This Form 10-K/A (Amendment No. 1) restates the Form 10-K for the year ended December 31, 2003 in its entirety. No attempt has been made in this amendment to modify or update the disclosures in the original Form 10-K except to give effect to the changes noted above. As a result, this Form 10-K/A (Amendment No. 1) contains forward-looking information which has not been updated for events subsequent to the date of the original filing, and the Company directs you to its Securities and Exchange Commission filings made subsequent to the original filing date for additional information.

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## PART I

### Item 1. Business

***Corporate Profile***

Cousins Properties Incorporated (the Registrant or Cousins ) is a Georgia corporation, which since 1987 has elected to be taxed as a real estate investment trust ( REIT ). Cousins Real Estate Corporation and its subsidiaries ( CREC ) is a taxable entity consolidated with the Registrant, which owns, develops, and manages its own real estate portfolio and performs certain real estate related services for other parties. The Registrant and CREC combined are hereafter referred to as the Company.

Cousins is an Atlanta-based, fully integrated, self administered equity REIT. The Company has extensive experience in the real estate industry, including the acquisition, financing, development, management and leasing of properties. Cousins has been a public company since 1962, and its common stock trades on the New York Stock Exchange under the symbol CUZ. The Company owns directly and through subsidiaries and joint ventures a portfolio of well-located, high-quality office, medical office, retail and residential development projects and holds several tracts of strategically located undeveloped land. The strategies employed to achieve the Company s investment goals include the development of properties which are leased to quality tenants; the maintenance of high levels of occupancy within owned properties; the development of single-family residential subdivisions; the selective sale and financing of assets; the creation of joint venture arrangements and the acquisition of quality income-producing properties at attractive prices. The Company also seeks to be opportunistic and take advantage of normal real estate business cycles.

Unless otherwise indicated, the notes referenced in the discussion below are the Notes to Consolidated Financial Statements included herein. Segment information for the three years ended December 31, 2003 is contained in Note 12 to the Consolidated Financial Statements included herein.

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***Brief Description of Company Investments***

*Office.* As of December 31, 2003, the Company s office portfolio included the following thirty-six commercial office buildings:

| Property Description | Metropolitan Area | Rentable Square Feet | Company s Economic Ownership Interest | Percent Leased (Fully Executed) |
|---|---|---|---|---|
| Bank of America Plaza | Atlanta | 1,262,000 | 50% | 100% |
| One Ninety One Peachtree Tower | Atlanta | 1,215,000 | 9.80% | 96% |
| Inforum | Atlanta | 990,000 | 100% | 94% |
| 3200 Windy Hill Road | Atlanta | 694,000 | 50% | 94% |
| 2300 Windy Ridge Parkway | Atlanta | 636,000 | 50% | 86% |
| The Pinnacle | Atlanta | 426,000 | 50% | 98% |
| One Georgia Center | Atlanta | 363,000 | 88.50% | 79% |
| 1155 Perimeter Center West | Atlanta | 362,000 | 50% | 99% |
| 2500 Windy Ridge Parkway | Atlanta | 316,000 | 50% | 99% |
| Two Live Oak Center | Atlanta | 279,000 | 50% | 87% |
| 4200 Wildwood Parkway | Atlanta | 259,000 | 50% | 100% |
| Ten Peachtree Place | Atlanta | 260,000 | 50% | 100% |
| 4300 Wildwood Parkway | Atlanta | 150,000 | 50% | 100% |
| 4100 Wildwood Parkway | Atlanta | 100,000 | 50% | 100% |
| 3100 Windy Hill Road | Atlanta | 188,000 | 100% | 100% |
| 555 North Point Center East | Atlanta | 152,000 | 100% | 53% |
| 615 Peachtree Street | Atlanta | 148,000 | 100% | 81% |
| 200 North Point Center East | Atlanta | 130,000 | 100% | 38% |
| 333 North Point Center East | Atlanta | 129,000 | 100% | 65% |
| 100 North Point Center East | Atlanta | 128,000 | 100% | 68% |
| 3301 Windy Ridge Parkway | Atlanta | 107,000 | 100% | 100% |
| | Georgia | 8,294,000 | | 90% |
| Lakeshore Park Plaza | Birmingham | 190,000 | 100%(a) | 87% |
| Grandview II | Birmingham | 149,000 | 11.50% | 100% |
| 600 University Park Place | Birmingham | 123,000 | 100%(a) | 99% |
| | Alabama | 462,000 | | 92% |
| Gateway Village | Charlotte | 1,065,000 | 50% | 100% |
| 101 Independence Center | Charlotte | 526,000 | 100% | 99% |
| Wachovia Tower | Greensboro | 324,000 | 11.50% | 67% |
| | North Carolina | 1,915,000 | | 98% |
| Frost Bank Tower | Austin | 525,000 | 100% | 55%(b) |
| Austin Research Park Building III | Austin | 174,000 | 50% | 100% |
| Austin Research Park Building IV | Austin | 184,000 | 50% | 100% |

| | | | | |
|---|---|---|---|---|
| The Points at Waterview | Dallas | 201,000 | 100% | 96% |
| | Texas | 1,084,000 | | 98% |
| John Marshall II | Washington, D.C. | 224,000 | 50% | 100% |
| 333 John Carlyle | Washington, D.C. | 153,000 | 100% | 91% |
| 1900 Duke Street | Washington, D.C. | 97,000 | 100% | 100% |
| | Washington, D.C. | 474,000 | | 96% |
| 101 Second Street | San Francisco | 387,000 | 100%(a) | 82% |
| 55 Second Street | San Francisco | 379,000 | 100%(a) | 78% |
| | California | 766,000 | | 80% |
| | | 12,995,000 | | 91% |

(a) These projects are owned in entities where the partner may receive a portion of the results of operations or sale.

(b) Under construction and in lease-up.

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The weighted average leased percentage of these office properties (excluding the property currently under construction and in lease-up and One Ninety One Peachtree Tower ( 191 Peachtree ), in which the Company owns less than 10%) was approximately 91% as of December 31, 2003, and the leases expire as follows:

| | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 & Thereafter | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| : | | | | | | | | | | | |
| | 170,866 | 272,470 | 415,201 | 201,979 | 427,110 | 573,511 | 318,934 | 85,410 | 344,836 | 695,023 | |
| | 5% | 8% | 12% | 6% | 12% | 16% | 9% | 2% | 10% | 20% | |
| | $ 2,971 | $ 4,558 | $ 6,662 | $ 3,444 | $ 8,595 | $ 9,956 | $ 8,346 | $ 1,359 | $ 10,934 | $ 16,649 | $ |
| | $ 17.39 | $ 16.73 | $ 16.05 | $ 17.05 | $ 20.12 | $ 17.36 | $ 26.17 | $ 15.91 | $ 31.71 | $ 23.95 | $ |
| *:* | | | | | | | | | | | |
| | 378,295 | 496,325 | 590,615 | 594,067 | 223,972 | 483,261 | 170,450 | 244,171 | 1,389,383 | 2,284,055 | |
| | 6% | 7% | 9% | 9% | 3% | 7% | 2% | 4% | 20% | 33% | |
| | $ 4,767 | $ 8,385 | $ 10,506 | $ 15,011 | $ 3,644 | $ 10,541 | $ 3,990 | $ 4,868 | $ 31,127 | $ 46,729 | $ |
| | $ 12.60 | $ 16.89 | $ 17.79 | $ 25.27 | $ 16.27 | $ 21.81 | $ 23.41 | $ 19.94 | $ 22.40 | $ 20.46 | $ |
| *ing only Company s % share of Joint Venture Properties):* | | | | | | | | | | | |
| | 436,630 | 483,921 | 703,378 | 501,498 | 530,214 | 809,974 | 374,036 | 210,950 | 1,039,612 | 1,812,941 | |
| | 6% | 7% | 10% | 7% | 8% | 12% | 6% | 3% | 15% | 26% | |
| | $ 5,980 | $ 8,106 | $ 11,783 | $ 10,987 | $ 10,250 | $ 15,114 | $ 9,755 | $ 3,795 | $ 26,497 | $ 39,581 | $ |
| | $ 13.70 | $ 16.75 | $ 16.75 | $ 21.91 | $ 19.33 | $ 18.66 | $ 26.08 | $ 17.99 | $ 25.49 | $ 21.83 | $ |

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(a) Where a tenant has the option to cancel its lease without penalty, the lease expiration date used in the table above reflects the cancellation option date rather than the lease expiration date.

(b) Rentable square feet leased as of December 31, 2003 out of approximately 4,028,000 total rentable square feet.

(c) Annual contractual rent excludes the operating expense reimbursement portion of the rent payable. If the lease does not provide for pass through of such operating expense reimbursements, an estimate of operating expenses is deducted from the rental rate shown. The contractual rental rate shown is the estimated rate in the year of expiration.

(d) Rentable square feet leased as of December 31, 2003 out of approximately 7,227,000 total rentable square feet.

The weighted average remaining lease term of the office portfolio (excluding the property currently under construction and 191 Peachtree) was approximately seven years as of December 31, 2003. Most of the Company s leases in these buildings provide for pass through of operating expenses to its tenants and contractual rents which escalate over time.

*Medical Office.* As of December 31, 2003, the Company s medical office portfolio included the following six medical office properties:

| Property Description | Metropolitan Area | | Rentable Square Feet | Company s Economic Ownership Interest | Percent Leased (Fully Executed) |
|---|---|---|---|---|---|
| Emory Crawford Long Medical Office Tower | Atlanta | | 358,000 | 50% | 92% |
| Northside/Alpharetta II | Atlanta | | 198,000 | 100% | 79% |
| Meridian Mark Plaza | Atlanta | | 160,000 | 100% | 100% |
| Northside/Alpharetta I | Atlanta | | 103,000 | 100% | 94% |
| AtheroGenics | Atlanta | | 51,000 | 100% | 100% |
| | | Georgia | 870,000 | | 91% |
| Presbyterian Medical Plaza at University | Charlotte | North Carolina | 69,000 | 11.50% | 100% |
| | | | 939,000 | | 91% |

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The weighted average leased percentage of these medical office properties was 91% as of December 31, 2003, and the leases expire as follows:

| | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 & Thereafter | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **CAL E** | | | | | | | | | | | |
| *dated:* | | | | | | | | | | | |
| Feet g | 33,636 | 23,836 | 15,272 | 32,538 | 39,723 | 125,538 | 17,865 | 30,354 | 2,010 | 144,197 | 464,96 |
| ased | 7% | 5% | 3% | 7% | 9% | 27% | 4% | 7% | 0% | 31% | 10 |
| tual 00 s) | $ 714 | $ 407 | $ 260 | $ 687 | $ 878 | $ 2,547 | $ 351 | $ 810 | $ 62 | $ 3,348 | $ 10,06 |
| tual . Ft. | $ 21.24 | $ 17.09 | $ 17.03 | $ 21.10 | $ 22.11 | $ 20.29 | $ 19.63 | $ 26.68 | $ 30.98 | $ 23.22 | $ 21.6 |
| *nture:* | | | | | | | | | | | |
| Feet g | 0 | 3,445 | 0 | 68,996 | 1,017 | 27,269 | 7,175 | 14,687 | 79,733 | 193,596 | 395,91 |
| ased | 0% | 1% | 0% | 17% | 0% | 7% | 2% | 4% | 20% | 49% | 10 |
| tual 00 s) | $ 0 | $ 56 | $ 0 | $ 1,263 | $ 20 | $ 609 | $ 155 | $ 359 | $ 1,642 | $ 4,721 | $ 8,82 |
| tual . Ft. | $ 0 | $ 16.40 | $ 0 | $ 18.31 | $ 19.87 | $ 22.34 | $ 21.59 | $ 24.45 | $ 20.59 | $ 24.39 | $ 22.2 |
| *ncluding only Company s % share of Joint Venture Properties):* | | | | | | | | | | | |
| Feet g | 33,636 | 24,232 | 15,272 | 57,505 | 40,232 | 139,173 | 21,453 | 37,698 | 26,283 | 240,995 | 636,47 |
| ased | 5% | 4% | 3% | 9% | 6% | 22% | 3% | 6% | 4% | 38% | 10 |
| tual 00 s) | $ 714 | $ 414 | $ 260 | $ 1,159 | $ 888 | $ 2,851 | $ 428 | $ 989 | $ 586 | $ 5,709 | $ 13,99 |
| tual . Ft. | $ 21.24 | $ 17.08 | $ 17.03 | $ 20.15 | $ 22.08 | $ 20.49 | $ 19.96 | $ 26.25 | $ 22.28 | $ 23.69 | $ 21.9 |

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(a) Rentable square feet leased as of December 31, 2003 out of approximately 512,000 total rentable square feet.

(b) Annual contractual rent excludes the operating expense reimbursement portion of the rent payable. If the lease does not provide for pass through of such operating expense reimbursements, an estimate of operating expenses is deducted from the rental rate shown. The contractual rental rate shown is the estimated rate in the year of expiration.

(c) Rentable square feet leased as of December 31, 2003 out of approximately 427,000 total rentable square feet.

The weighted average remaining lease term of the medical office portfolio was approximately eight years as of December 31, 2003. Most of the Company s leases in these medical office buildings provide for pass through of operating expenses to its tenants and contractual rents which escalate over time.

*Retail*. As of December 31, 2003, the Company s retail portfolio included the following eleven properties:

| Property Description | Metropolitan Area | Rentable Square Feet | Company s Economic Ownership Interest | Percent Leased (Fully Executed) |
|---|---|---|---|---|
| North Point MarketCenter | Atlanta | 401,000 | 11.50% | 100% |
| The Avenue East Cobb | Atlanta | 226,000 | 100% | 100% |
| The Avenue West Cobb | Atlanta | 205,000 | 100% | 92%(a) |
| The Avenue Peachtree City | Atlanta | 169,000 | 88.50%(b) | 98% |
| Mansell Crossing Phase II | Atlanta | 103,000 | 11.50% | 100% |
| | Georgia | 1,104,000 | | 99% |
| The Avenue of the Peninsula | Rolling Hills Estates | 374,000 | 100% | 86% |
| Los Altos MarketCenter | Long Beach | 157,000 | 11.50% | 100% |
| | California | 531,000 | | 87% |
| The Shops at World Golf Village | St. Augustine | 80,000 | 50% | 74% |
| The Avenue Viera | Viera | 333,000 | 100% | 27%(a) |
| | Florida | 413,000 | | 74% |
| The Shops of Lake Tuscaloosa | Tuscaloosa, Alabama | 62,000 | 100% | 85%(a) |
| Greenbrier MarketCenter | Chesapeake, Virginia | 376,000 | 11.50% | 100% |
| | | 2,486,000(c) | | 93% |

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(a) Under construction and/or in lease-up.

(b) This property is subject to a contractual participation in which a third party may receive a portion of the results of operations or sale.

(c) The Company has a 10% interest in Deerfield Towne Center, a 371,000 square foot retail project that is currently under construction in Deerfield (Cincinnati), Ohio. The Company has no capital invested in the project, but is entitled to receive 10% of the net operating income after debt service and 10% of any residuals upon sale.



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The weighted average leased percentage of these retail properties (excluding the properties currently under construction and/or in lease-up) was approximately 93% as of December 31, 2003, and the leases expire as follows:

| | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 & Thereafter | Tota |
|---|---|---|---|---|---|---|---|---|---|---|---|
| *ed:* | | | | | | | | | | | |
| et | 33,586 | 82,982 | 65,007 | 14,568 | 5,735 | 17,111 | 79,323 | 53,606 | 18,004 | 179,077 | 548 |
| ed | 6% | 15% | 12% | 3% | 1% | 3% | 15% | 10% | 3% | 32% | |
| l s) | $ 534 | $ 2,251 | $ 1,595 | $ 167 | $ 166 | $ 560 | $ 2,009 | $ 644 | $ 564 | $ 3,631 | $ 12 |
| l t. | $ 15.91 | $ 27.12 | $ 24.54 | $ 11.48 | $ 28.88 | $ 32.71 | $ 25.33 | $ 12.02 | $ 31.35 | $ 20.28 | $ 2 |
| *ure:* | | | | | | | | | | | |
| et | 26,600 | 50,695 | 167,790 | 79,005 | 55,721 | 39,155 | 101,551 | 142,866 | 236,849 | 360,860 | 1,261 |
| ed | 2% | 4% | 13% | 6% | 5% | 3% | 8% | 11% | 19% | 29% | |
| l s) | $ 572 | $ 722 | $ 2,298 | $ 1,658 | $ 1,041 | $ 561 | $ 1,159 | $ 2,186 | $ 3,588 | $ 6,057 | $ 19 |
| l t. | $ 21.50 | $ 14.25 | $ 13.70 | $ 20.98 | $ 18.68 | $ 14.33 | $ 11.41 | $ 15.30 | $ 15.15 | $ 16.79 | $ 1 |
| *uding only Company s % share of Joint Venture Properties):* | | | | | | | | | | | |
| et | 37,220 | 90,352 | 104,532 | 47,956 | 46,794 | 26,691 | 93,790 | 78,754 | 78,019 | 240,073 | 844 |
| ed | 5% | 11% | 12% | 6% | 6% | 3% | 11% | 9% | 9% | 28% | |
| l s) | $ 615 | $ 2,369 | $ 2,371 | $ 927 | $ 985 | $ 756 | $ 2,192 | $ 1,153 | $ 1,722 | $ 4,722 | $ 17 |
| l t. | $ 16.51 | $ 26.22 | $ 22.68 | $ 19.34 | $ 21.06 | $ 28.31 | $ 23.37 | $ 14.64 | $ 22.07 | $ 19.67 | $ 2 |

(a) Gross leasable area leased as of December 31, 2003 out of approximately 600,000 total gross leasable area.

(b) Annual contractual rent excludes the operating expense reimbursement portion of the rent payable and any percentage rents due. If the lease does not provide for pass through of such operating expense reimbursements, an estimate of operating expenses is deducted from the rental rate shown. The contractual rental rate shown is the estimated rate in the year of expiration.

(c) Gross leasable area leased as of December 31, 2003 out of approximately 1,286,000 total gross leasable area.

The weighted average remaining lease term of the retail portfolio (excluding the properties currently under construction and/or in lease-up) was approximately seven years as of December 31, 2003. Most of the Company s leases in these retail properties provide for pass through of operating expenses to its tenants and contractual rents which escalate over time.

Residential/Land Division. The Company s other real estate holdings include interests in over 280 acres of strategically located land held for investment or future development at North Point and Wildwood Office Park and the option to acquire the fee simple interest in approximately 7,100 acres of land through its Temco Associates joint venture, among other holdings. See the table of Residential Lots Under Development and Land Held for Investment or Future Development for further information.

Other. The Company s joint venture partners include, but are not limited to, either the following companies or their affiliates: IBM, The Coca-Cola Company ( Coca-Cola ), Bank of America Corporation ( Bank of America ), The Prudential Insurance Company of America ( Prudential ), Temple-Inland Inc., Equity Office Properties Trust, CarrAmerica Realty Corporation and Emory University.

A table detailing the Company s real estate properties is included in Item 2 of this Report.

***Significant Changes in 2003***

Significant changes in the Company s business and properties during the year ended

December 31, 2003 were as follows:

Office Division. The Company sold AT&T Wireless Services Headquarters, a 222,000 rentable square foot office building, and Cerritos Corporate Center Phase II, a 105,000 rentable square foot office building (collectively called Cerritos ), in a single transaction in the second quarter of 2003.

In December 2003, the Company purchased the remaining interest in 100 and 200 North Point Center East from CP Venture Two LLC (see Note 5). The purchase price was equal to the outstanding balance of its mortgage note payable at the time of sale, or $22.4 million. The mortgage note payable bears interest at 7.86% and matures August 1, 2007.

*Retail Division.* CP Venture Three LLC (see Note 5) sold Mira Mesa MarketCenter, a 480,000 square foot retail center in San Diego, California, in the second quarter of 2003.

Presidential MarketCenter ( Presidential ), a 374,000 rentable square foot retail center in Atlanta, Georgia, was sold in the third quarter of 2003. The purchaser assumed the Presidential mortgage note payable in the sale. Also, in the third quarter of 2003, the Company sold Perimeter Expo ( Expo ), a 176,000 square foot retail center in Atlanta, Georgia. The Expo note payable was re-collateralized as corporate, unsecured debt and not repaid.

In October 2003, The Avenue West Cobb, a 205,000 square foot retail center in Atlanta, Georgia, became partially operational for financial reporting purposes. In December 2003, the Company purchased approximately eight acres of land adjacent to The Avenue West Cobb, which could be utilized for future development. Also in December 2003, The Shops of Lake Tuscaloosa, a 62,000 square foot retail center in Tuscaloosa, Alabama, became partially operational for financial reporting purposes.

In October 2003, the Company purchased approximately 58 acres of land in Brevard County, Florida, for the development of The Avenue Viera, a 408,000 square foot retail center, of which the Company owns 333,000 square feet, in Viera, Florida. Construction commenced on this center in December 2003.

*Land Division*. The Company is developing two residential communities in suburban Atlanta, Georgia and one in Pine Mountain, Georgia. Approximately 1,151 lots are being developed within these three communities, of which 214, 137 and 1 lots were sold in 2003, 2002 and 2001, respectively. In 2002 and 2001, the Company also sold 49 and 120 lots, respectively, at residential developments in which all the lots have been sold. The Company s share of lots sold at joint ventures was 277, 145 and 117 for 2003, 2002 and 2001, respectively. The Company also entered into new joint venture arrangements in 2003 for the development of residential communities. See the Residential Lots Under Development table in Item 2 for more detail.

In September 2003, the Company sold approximately 10.5 acres of Company-owned land in Wildwood Office Park for a net gain of approximately $1,947,000. In December 2003, the Company sold approximately 42 acres of North Point West Side land for a net gain of approximately $5,323,000.

*Financings.* In May 2003, Crawford Long CPI, LLC, an entity in which the Company owns a 50% interest, obtained a $55 million mortgage note payable. The note has a maturity date of June 1, 2013 and an interest rate of 5.9%. A distribution of approximately $25.8 million was made to the Company in 2003 for its share of the proceeds from this mortgage.

***Stock Repurchase Plan***

In November 2001, the Board of Directors of the Company adopted a stock repurchase plan authorizing the repurchase of up to five million shares of common stock prior to January 1, 2004 (see Note 6). During January 2003, the Company purchased an additional 234,100 shares at an average price of $23.66 per share. As of December 31, 2003, the Company had repurchased a total of 2,691,582 shares for an aggregate price of $64,893,935.

***Subsequent Event***

The Mirant Corporation ( Mirant ), leased 99% of 1155 Perimeter Center West, which is owned by 285 Venture, LLC. The Company owns 50% of 285 Venture, LLC. Mirant declared

bankruptcy during 2003. In January 2004, the Mirant lease was renegotiated and Mirant reduced its amount of leased space, the term of its lease and its rental rate. The Company is actively attempting to re-lease the vacated space, but the impact on income of 285 Venture, LLC in 2004 and beyond is not known at this time.

***Environmental Matters***

Under various federal, state and local laws, ordinances and regulations, an owner or operator of real estate is generally liable for the costs of removal or remediation of certain hazardous or toxic substances on or in such property. Such laws often impose liability without regard to whether the owner knew of, or was responsible for, the presence of such hazardous or toxic substances. The presence of such substances, or the failure to remediate such substances properly, may subject the owner to substantial liability and may adversely affect the owner s ability to develop the property or to borrow using such real estate as collateral. The Company is not aware of any environmental liability that the Company s management believes would have a material adverse effect on the Company s business, assets or results of operations.

Certain environmental laws impose liability on a previous owner of property to the extent that hazardous or toxic substances were present during the prior ownership period. A transfer of the property does not relieve an owner of such liability. Thus, although the Company is not aware of any such situation, the Company may be liable in respect of properties previously sold.

In connection with the development or acquisition of certain properties, the Company has obtained Phase One environmental audits (which generally involve inspection without soil sampling or ground water analysis) from independent environmental consultants. The remaining properties (including most of the Company s land held for investment or future development) have not been so examined. No assurance can be given that environmental liabilities do not exist, that the reports revealed all environmental liabilities, or that no prior owner created any material environmental condition not known to the Company.

The Company believes that it and its properties are in compliance in all material respects with all federal, state and local laws, ordinances and regulations regarding hazardous or toxic substances.

***Competition***

The Company s properties compete for tenants with similar properties located in our markets primarily on the basis of location, rental rates, services provided and the design and condition of the facilities. The Company also competes with other real estate companies, financial institutions, pension funds, partnerships, individual investors and others when attempting to acquire and develop properties. The Land Division also competes with other lot developers.

***Forward-Looking Statements***

Certain matters contained in this report are forward-looking statements within the meaning of the federal securities laws and are subject to uncertainties and risks. These include, but are not limited to, general and local economic conditions, local real estate conditions, the activity of others developing competitive projects, the cyclical nature of the real estate industry, the financial condition of existing tenants, interest rates, the Company s ability to obtain favorable financing or zoning, environmental matters, the effects of terrorism, the failure of assets under contract for sale to ultimately close, and other risks detailed from time to time in the Company s filings with the Securities and Exchange Commission, including the Company s Current Report on Form 8-K filed on December 10, 2003. The words believes, expects, anticipates, estimates, and similar expressions are intended to identify forward-looking statements. Although the Company believes that its plans, intentions and expectations reflected in any forward-looking statements are

reasonable, the Company can give no assurance that such plans, intentions or expectations will be achieved. Such forward-looking statements are based on current expectations and speak as of the date of such statements. The Company undertakes no obligation to publicly update or revise any forward-looking statement, whether as a result of future events, new information or otherwise.

***Executive Offices; Employees***

The Registrant s executive offices are located at 2500 Windy Ridge Parkway, Suite 1600, Atlanta, Georgia 30339-5683. At December 31, 2003, the Company employed 421 people.

***Available Information***

The Company makes available free of charge on the Investor Relations page of its Web site, www.cousinsproperties.com, its filed and furnished reports on Forms 10-K, 10-Q and 8-K, and all amendments thereto, as soon as reasonably practicable after the reports are filed with or furnished to the Securities and Exchange Commission.

The Company s Corporate Governance Guidelines, Director Independence Standards, Code of Business Conduct and Ethics, and the Charters of the Audit Committee and the Compensation, Succession, Nominating and Governance Committee of the Board of Directors are also available on the Investor Relations page of the Company s Web site. The information contained on the Company s Web site is not incorporated herein by reference.

Copies of these documents (without exhibits, when applicable) are also available free of charge upon request to the Company at 2500 Windy Ridge Parkway, Suite 1600, Atlanta, Georgia 30339-5683, Attention: Mark A. Russell, Vice President Chief Financial Analyst and Director of Investor Relations. Mr. Russell, the Company s investor relations contact, may also be reached by telephone at (770) 857-2449, by facsimile at (770) 857-2360 or by email at markrussell@cousinsproperties.com.

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## **Item 2. Properties**

### ***Table of Major Office and Retail Properties***

The following tables set forth certain information relating to major office, medical office and retail properties, stand alone retail lease sites, and land held for investment and future development in which the Company has a 10% or greater ownership interest. Information presented in Note 5 provides additional information related to its joint ventures. All information presented is as of December 31, 2003. Dollars are stated in thousands.

| n, e | Year Development Completed or Acquired | Venture Partner | Company's Ownership Interest | Rentable Square Feet and Acres | Percentage Leased as of December 31, 2003 | Average 2003 Economic Occupancy | Major Tenants (lease expiration/options expiration) | Major Tenants Rentable Sq. Feet | Adjusted Cost and Adjusted Cost Less Depreciation and Amortization (1) | Debt Balance |
|---|---|---|---|---|---|---|---|---|---|---|
| A 2 | 1999 | N/A | 100% | 990,000 | 94% | 94% | BellSouth Corporation (3)(2009) | 277,744 | $ 83,930 | $ 0 |
| | | | | 4 Acres (2) | | | Georgia Lottery Corp. (2013) | 127,827 | $ 52,438 | |
| | | | | | | | Co Space Services, LLC(2020/2025) | 110,797 | | |
| | | | | | | | Lockwood Greene Engineers, Inc.(2004)(4) | 95,722 | | |
| | | | | | | | Turner Broadcasting (2006/2016) | 57,827 | | |
| | | | | | | | Sapient Corporation (2009/2019) | 57,689 | | |
| ce NC ) | 1996 | N/A | 100% | 526,000 | 99% | 99% | Bank of America | 359,327 | $ 77,773(5) | $ 43,912 |
| | | | | 2 Acres (5) | | | (2008/2028)(6) | | $ 56,011(5) | |
| | | | | | | | Robinson Bradshaw & Hinson, P.A. (2014)(7) | 89,584 | | |
| | | | | | | | Ernst & Young LLP (2004) | 24,125 | | |
| | (8) | N/A | 100% | 525,000 | 55%(8) | (8) | Graves, Dougherty, Hearon | 64,210(8) | $ 105,390(8) | $ 0 |

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| ) | | | | 2 Acres | | | & Moody, P.C. (2020/2035)(8) | | | |
| | | | | | | | Frost National Bank (2014/2039) | 51,958 | | |
| | | | | | | | Winstead, Sechrest & Minick P.C. (2014/2024)(8) | 51,875(8) | | |
| | | | | | | | Jenkens & Gilchrist (2014)(8) | 46,662(8) | | |
| co, | 2000 | Myers Second Street Company LLC | 100% (9) | 387,000 1 Acre | 82% | 83% | Thelen, Reid & Priest (2012/2022) | 135,788 | $ 92,371 $ 79,615 | $ 87,182 |
| | | | | | | | Ziff Davis Media (2010/2015) | 35,284 | | |
| | | | | | | | Nexant (2009) | 34,933 | | |

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| , | Year Development Completed or Acquired | Venture Partner | Company s Ownership Interest | Rentable Square Feet and Acres | Percentage Leased as of December 31, 2003 | Average 2003 Economic Occupancy | Major Tenants (lease expiration/options expiration) | Major Tenants Rentable Sq. Feet | Adjusted Cost and Adjusted Cost Less Depreciation and Amortization (1) | Debt Balance |
|---|---|---|---|---|---|---|---|---|---|---|
| *ued)* | | | | | | | | | | |
| et CA | 2002 | Myers Bay Area Company LLC | 100% (9) | 379,000 | 78% | 50% | KPMG (2014/2024) | 89,927 | $ 110,493 | $ ( |
| | | | | 1 Acre | | | Paul Hastings (2017/2027) | 73,708 | $ 104,362 | |
| | | | | | | | UPS Freight Services (2012/2017) | 57,380 | | |
| | | | | | | | Preston Gates (2014/2024) | 43,968 | | |
| s, | 2000 | N/A | 100% | 201,000 | 96% | 84% | Bombadier Aerospace Corp. (2013/2023) | 97,740 | $ 29,804(5) | $ ( |
| | | | | 15 Acres(5) | | | | | $ 25,525(5) | |
| | | | | | | | Liberty Mutual (2011/2021) | 28,124 | | |
| | | | | | | | Cisco Systems, Inc. (2005/2010) | 20,433 | | |
| L | 1998 | Daniel Realty Company | 100% (9) | 190,000 | 87% | 80% | Infinity Insurance (2005/2015) | 107,293 | $ 15,756 | $ 9,861 |
| | | | | 12 Acres | | | | | $ 13,253 | |
| L | 2000 | Daniel Realty Company | 100% (9) | 123,000 | 99% | 98% | Southern Company, Inc. (3) (2010) | 41,961 | $ 20,661 | $ 13,676 |
| | | | | 10 Acres | | | | | $ 16,327 | |
| le | | | | | | | Southern Progress (2006) | 25,465 | | |
| C. | 1999 | N/A | 100% | 153,000 | 91% | 92% | A.T. Kearney (2009/2019) | 94,115 | $ 28,581 | $ 47,922 |
| | | | | 1 Acre | | | | | $ 23,380 | |

| | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| et<br>C. | 2000 | N/A | 100% | 97,000<br>1 Acre | 100% | 100% | Municipal Securities Rulemaking Board (2016/2026) | 47,556 | $ 23,598 | | (10 |
| | | | | | | | | | $ 21,086 | | |
| | | | | | | | American Society of Clinical Oncology (2010/2015) | 39,529 | | | |
| t<br>ta, | 1995(11) | N/A | 100% | 128,000<br>7 Acres | 68% | 67% | Schweitzer-Mauduit International, Inc. (2007/2012) | 32,696 | $ 11,320 | $ 22,365 | |
| | | | | | | | | | $ 11,150 | | |
| t<br>ta, | 1996(11) | N/A | 100% | 130,000<br>9 Acres | 38% | 31% | APAC Teleservices, Inc. (2004/2009) | 22,409 | $ 9,964 | | (12 |
| | | | | | | | | | $ 9,796 | | |
| | | | | | | | Dean Witter (2007) | 15,709 | | | |

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| Description, Location and Zip Code | Year Development Completed or Acquired | Venture Partner | Company's Ownership Interest | Rentable Square Feet and Acres | Percentage Leased as of December 31, 2003 | 2003 Average Economic Occupancy | Major Tenants (lease expiration/options expiration) | Major Tenants Rentable Sq. Feet | Adjusted Cost and Adjusted Cost Less Depreciation and Amortization (1) | Debt Balance | Debt Maturity and Interest Rate |
|---|---|---|---|---|---|---|---|---|---|---|---|
| ***Office (Continued)*** | | | | | | | | | | | |
| 333 North Point Center East Suburban Atlanta, GA 30022-8274 | 1998 | N/A | 100% | 129,000 | 65% | 60% | Merrill Lynch (2014/2024) | 35,949 | $ 12,004 | $ 31,424(13) | 11/1/11 |
| | | | | 9 Acres | | | J.C. Bradford (2005/2012) | 22,102 | $ 9,100 | | 7.00% |
| | | | | | | | Phillip Morris (2008/2013) | 17,051 | | | (13) |
| 555 North Point Center East Suburban Atlanta, GA 30022-8274 | 2000 | N/A | 100% | 152,000 | 53% | 55% | Regus Business Centre (2011/2016) | 22,422 | $ 15,219 | (13) | (13) |
| | | | | 10 Acres | | | | | $ 12,052 | | |
| | | | | | | | Matria Healthcare, Inc. (2006/2011) | 12,375 | | | |
| | | | | | | | Robert W. Baird (2011/2016) | 11,064 | | | |
| 615 Peachtree Street Atlanta, GA 30308-2312 | 1996 | N/A | 100% | 148,000 | 81% | 88% | Wachovia (3)(2009/2014) | 59,073 | $ 12,861 | $ 0 | N/A |
| | | | | 2 Acres | | | KPS Group (2005/2010) | 11,029 | $ 8,774 | | |
| One Georgia Center Atlanta, GA 30308-3619 | 2000 | Prudential (3) | 88.50% | 363,000 | 79% | 79% | Norfolk & Southern (2004/2014) | 89,041 | $ 38,942(5) | $ 0 | N/A |
| | | | | 3 Acres (5) | | | SouthTrust Bank (2004) | 96,687 | $ 34,826(5) | | |

| | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Wildwood Office Park, Atlanta, GA: | | | | | | | | | | | |
| 2300 Windy Ridge Parkway 30339-5671 | 1987 | IBM | 50% | 636,000<br>12 Acres | 86% | 86% | Manhattan Associates, LLC (2008/2013) (16) | 125,392 | $ 82,193<br>$ 41,566 | $ 55,530 | 12/1/05<br>7.56% |
| | | | | | | | Computer Associates (2005/2010) | 62,445 | | | |
| | | | | | | | Profit Recovery Group (2005/2010) | 62,576 | | | |
| | | | | | | | Financial Services Corporation (2006/2011) | 61,938 | | | |
| | | | | | | | Life Office Management Associates (2005/2010) (15) | 59,251 | | | |
| | | | | | | | Chevron USA (2005) (14) | 51,415 | | | |
| 2500 Windy Ridge Parkway 30339-5683 | 1985 | IBM | 50% | 316,000<br>8 Acres | 99% | 90% | Coca-Cola Enterprises Inc. (2018/2023) | 223,938 | $ 30,383<br>$ 13,905 | $ 19,825 | 12/15/05<br>7.45% |
| | | | | | | | Cousins Properties Incorporated (2005) | 45,195 | | | |

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| Description, Location and Zip Code | Year Development Completed or Acquired | Venture Partner | Company s Ownership Interest | Rentable Square Feet and Acres | Percentage Leased as of December 31, 2003 | Average 2003 Occupancy | Major Tenants (lease expiration/options) | Major Tenants Rentable Sq. Feet | Adjusted Cost and Adjusted Cost Less Depreciation and Amortization (1) | Debt Balance | Debt Maturity and Interest Rate |
|---|---|---|---|---|---|---|---|---|---|---|---|
| ***Office (Continued)*** | | | | | | | | | | | |
| 3200 Windy Hill Road 30339-5609 | 1991 | IBM | 50% | 694,000<br>15 Acres | 94% | 94% | Coca-Cola Enterprises (2013/2018) (16) | 236,050 | $ 87,546<br>$ 49,968 | $ 61,753 | 1/1/07<br>8.23% |
| | | | | | | | IBM (2006/2014) | 185,439 | | | |
| | | | | | | | General Electric (17) | 79,661 | | | |
| | | | | | | | IBM (2009/2014)(18) | 69,708 | | | |
| | | | | | | | W.H. Smith Inc. (2012/2017) | 42,018 | | | |
| 4100 and 4300 Wildwood Parkway 30339-8400 | 1996 | IBM | 50% | 250,000<br>13 Acres | 100% | 100% | Georgia-Pacific Corporation (2012/2017)(19) | 250,000 | $ 26,375<br>$ 18,724 | $ 25,967 | 4/1/12<br>7.65% |
| 4200 Wildwood Parkway 30339-8402 | 1997 | IBM | 50% | 259,000<br>8 Acres | 100% | 100% | General Electric (3)(2014/2024) | 259,000 | $ 36,750<br>$ 29,223 | $ 39,543 | 3/31/14<br>6.78% |
| 3301 Windy Ridge Parkway 30339-5685 | 1984 | N/A | 100% | 107,000<br>10 Acres | 100% | 100% | Indus International, Inc. (2012/2017) | 107,000 | $ 12,763<br>$ 6,280 | $ 0 | N/A |
| 3100 Windy Hill Road 30339-5605 | 1983 | N/A | 100%(20) | 188,000<br>13 Acres | 100% | 100% | IBM (2006) | 188,000 | $ 17,005<br>$ 12,244 | $ 0 | N/A |
| Bank of America Plaza Atlanta, GA 30308-2214 | 1992 | Bank of America | 50% | 1,262,000 | 100% | 100% | Bank of America | 579,190 | $ 224,557 | (21) | (21) |

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | (3) | | 4 Acres | | | (3)(2012/2042) Troutman Sanders (2007/225,033) | $ 143,816 | | |
| | | | | | | | Ernst & Young LLP(2002/4017) | | | |
| | | | | | | | Hunton & Williams (2009/293,6462) | | | |
| | | | | | | | Paul Hastings (2012/292,7313) | | | |
| Gateway Village Charlotte, NC 28202-1125 | 2001 | Bank of America (3) | 50% | 1,065,000 | 100% | 100% | Bank of America (3)(21,065,000) | $ 203,768 | $ 173,176 | 12/1/16 |
| | | | | 8 Acres | | | | $ 186,511 | | 6.41% |
| The Pinnacle Atlanta, GA 30326-1234 | 1999 | LORET | 50% | 426,000 | 98% | 97% | Merrill Lynch (2010/202,371) | $ 92,411 | $ 66,893 | 12/31/09 |
| | | Holdings, L.L.P. | | 4 Acres | | | A.T. Kearney (2009/207,566) | $ 70,715 | | 7.11% |
| | | | | | | | UBS PaineWebber471,631 (2013/2018)(24) | | | |

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| Description, Location and Zip Code | Year Development Completed or Acquired | Venture Partner | Company's Ownership Interest | Rentable Square Feet and Acres | Percentage Leased as of December 31, 2003 | 2003 Average Economic Occupancy | Major Tenants (lease expiration/options expiration) | Major Tenants Rentable Sq. Feet | Adjusted Cost and Adjusted Cost Less Depreciation and Amortization (1) | Debt Balance | Debt Maturity and Interest Rate |
|---|---|---|---|---|---|---|---|---|---|---|---|
| ***Office (Continued)*** | | | | | | | | | | | |
| Two Live Oak Center<br>Atlanta, GA<br>30326-1234 | 1997 | LORET Holdings, L.L.P. | 50% | 279,000<br>2 Acres | 87% | 81% | Chubb & Son, Inc. (3)<br>(2013/2033) | 66,770 | $ 48,796<br>$ 34,203 | $ 28,148 | 10/1/07<br>7.90% |
| | | | | | | | Dendrite International<br>(2007/2017) | 65,451 | | | |
| 1155 Perimeter Center West<br>Atlanta, GA<br>30338-5416 | 2000 | J. P. Morgan (3) | 50% | 362,000<br>6 Acres | 99% | 99% | Mirant Corporation<br>(2015)(25) | 360,395 | $ 55,398<br>$ 44,477 | $ 0 | N/A |
| Ten Peachtree Place<br>Atlanta, GA<br>30309-3814 | 1991 | Coca-Cola (3) | 50% | 260,000<br>5 Acres (5) | 100% | 90% | AGL Services Co.<br>(2013/2028) | 226,779 | $ 40,592(5) | $ 11,015 | 12/31/08 |
| | | | | | | | Domtar<br>(2006)(26) | 32,720 | $ 32,121(5) | | LIBOR + 0.75% |
| John Marshall-II<br>Suburban<br>Washington, D.C.<br>22102-3802 | 1996 | CarrAmerica Realty Corporation (3) | 50% | 224,000<br>3 Acres | 100% | 100% | Booz-Allen & Hamilton<br>(2011/2016) | 224,000 | $ 27,768<br>$ 19,634 | $ 18,076 | 4/1/13<br>7.00% |
| Austin Research Park - Building III<br>Austin, TX<br>78759-2314 | 2001 | CommonWealth Pacific, LLC and CalPERS | 50% | 174,000<br>4 Acres (5) | 100% | 100% | Charles Schwab & Co., Inc.<br>(2012/2032)(27) | 174,000 | $ 24,683(5)<br>$ 22,387(5) | $ 0 | N/A |
| Austin Research Park - | 2001 | CommonWealth | 50% | 184,000 | 100% | 100% | Charles Schwab & Co., Inc. | 184,000 | $ 27,556(5) | $ 0 | N/A |

| | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Building IV<br>Austin, TX<br>78759-2314 | | | | | | | | | | | | | |
| | Pacific,<br>LLC<br>and<br>CalPERS | | | | 7 Acres<br>(5) | | | (2012/2032)(27) | | $ 25,252(5) | | | |
| Wachovia Tower<br>Greensboro, NC<br>27401-2167 | Prudential | 1990 | (3) | 11.50% | 324,000 | 67% | 66% | Smith Helms<br>Mullis &<br>Moore | 70,360 | $ 54,692 | $ | 0 | N/A |
| | | | | | 1 Acre | | | (2010/2015) | | $ 36,695 | | | |
| | | | | | | | | Wachovia Bank<br>(3)<br>(2014/2024) | 62,280 | | | | |
| Grandview II<br>Birmingham, AL<br>35243-1930 | Prudential | 1998 | (3) | 11.50% | 149,000 | 100% | 100% | Fortis Benefits<br>Insurance<br>Company | 68,758 | $ 23,115 | $ | 0 | N/A |
| | | | | | 8 Acres | | | (2005/2011) | | $ 15,490 | | | |
| | | | | | | | | Daniel Realty<br>Company (2008) | 23,440 | | | | |

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| Description, Location and Zip Code | Year Development Completed or Acquired | Venture Partner | Company's Ownership Interest | Rentable Square Feet and Acres | Percentage Leased as of December 31, 2003 | 2003 Average Economic Occupancy | Major Tenants (lease expiration/options expiration) | Major Tenants Rentable Sq. Feet | Adjusted Cost and Adjusted Cost Less Depreciation and Amortization (1) | Debt Balance | Debt Maturity and Interest Rate |
|---|---|---|---|---|---|---|---|---|---|---|---|
| ***Medical Office*** | | | | | | | | | | | |
| Northside/Alpharetta I<br>Suburban Atlanta, GA<br>30005-3707 | 1998 | N/A | 100% | 103,000<br>1 Acre (28) | 94% | 94% | Northside Hospital (3)(2013)(29) | 49,128 | $ 15,986<br>$ 12,465 | $ 9,709 | 1/1/06<br>7.70% |
| Northside/Alpharetta II<br>Suburban Atlanta, GA<br>30005-3707 | 1999 | N/A | 100% | 198,000<br>2 Acres (28) | 79% | 74% | Northside Hospital (3)(2019)(30) | 81,120 | $ 18,600<br>$ 15,199 | $ 0 | N/A |
| Meridian Mark Plaza<br>Atlanta, GA<br>30342-1613 | 1999 | N/A | 100% | 160,000<br>3 Acres | 100% | 100% | Northside Hospital (3) (2013/2023)(31)<br>Scottish Rite Hospital for Crippled Children, Inc. (2013/2018)(31) | 51,054<br>29,556 | $ 26,067<br>$ 20,777 | $ 24,635 | 9/1/10<br>8.27% |
| AtheroGenics<br>Suburban Atlanta, GA<br>30004-2148 | 1999 | N/A | 100% | 51,000<br>4 Acres | 100% | 100% | AtheroGenics (2009/2019) | 51,000 | $ 7,655<br>$ 5,157 | $ 0 | N/A |
| Emory Crawford Long Medical | 2002 | Emory University | 50% | 358,000 | 92% | 85% | Emory University | 136,697 | $ 49,708 | $ 54,661 | 6/1/13 |

| | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Office Tower<br>Atlanta, GA<br>30308-2242 | | | | | | | (2017/2047) | | | | |
| | | | | (32) | | | | | $ 45,783 | | 5.90% |
| Presbyterian Medical Plaza at University<br>Charlotte, NC<br>28233-3549 | 1997 | Prudential<br>(3) | 11.50% | 69,000<br>1 Acre<br>(33) | 100% | 100% | Novant Health, Inc.<br>(2012/2027)(34) | 63,862 | $ 8,615<br>$ 6,500 | $ 0 | N/A |
| ***Retail Centers*** | | | | | | | | | | | |
| The Avenue Viera<br>Viera, FL<br>32940-9999 | (8) | N/A | 100% | 408,000<br>(333,000 owned by the Company)<br>58 acres | 27%(8) | (8) | Rave Motion Pictures (35)<br>Belk, Inc. (2024/2044)(8)(36) | N/A<br>65,947(8) | $ 9,175<br>(8) | $ 0 | N/A |
| The Avenue of the Peninsula<br>Rolling Hills Estates, CA<br>90274-3664 | 1999 | N/A | 100% | 374,000<br><br>14 Acres | 86% | 88% | Regal Cinema (2015/2030)<br>Saks & Company (2019/2040)<br>Borders (2018/2038)<br>Restoration Hardware (2010/2020)<br>Pottery Barn (2013) | 55,673<br>42,494<br>24,386<br>12,521<br>12,089 | $ 92,986<br>$ 77,034 | $ 0 | N/A |

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| Year Development Completed or Acquired | Venture Partner | Company s Ownership Interest | Rentable Square Feet and Acres | Percentage Leased as of December 31, 2003 | Average 2003 Economic Occupancy | Major Tenants (lease expiration/options expiration) | Major Tenants Rentable Sq. Feet | Adjusted Cost and Adjusted Cost Less Depreciation and Amortization (1) |
|---|---|---|---|---|---|---|---|---|
| ***inued)*** | | | | | | | | |
| 999 | N/A | 100% | 226,000<br>30 Acres | 100% | 97% | Borders, Inc. (2015/2030)<br>Bed, Bath & Beyond (2010/2025)<br>Gap (2005/2015)<br>Talbot s (2010/2020)<br>Pottery Barn (3)(2006/2012) | 24,882<br>21,000<br>19,434<br>12,905<br>10,000 | $ 41,355<br>$ 30,705 |
| 03(37) | N/A | 100% | 205,000<br>22 Acres | 92%(37) | 18%(37) | Linens N Things (2014/2028)<br>Barnes & Noble (2013/2023)<br>Pier One Imports (2013/2023)<br>Aspen s Signature Steaks (2019/2024) | 28,030<br>24,025<br>9,980<br>9,580 | $ 30,437(37<br>$ 30,197(37 |
| 03(37) | N/A | 100% | 62,000<br>12 Acres | 85%(37) | 3%(37) | Publix Super Markets (3) (2023/2053) | 44,271 | $ 7,288(37<br>$ 7,280(37 |
| 001 | Prudential (3) | 88.50%(9) | 169,000<br>18 Acres | 98% | 97% | Books a Million (2008/2013)<br>Gap (2012/2022)<br>Homebanc Mortgage Corporation (2007/2012)<br>Banana Republic (3)(2012/2022) | 13,750<br>10,822<br>8,851<br>8,015 | $ 30,207<br>$ 25,765 |
| 999 | W.C. Bradley Co. | 50% | 80,000 | 74% | 74% | Bradley Specialty Retailing, | 31,044 | $ 13,566 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | | | 3 Acres | | | Inc. (2013/2023) | | $ 10,905 |
| 4/1995 | Prudential (3) | 11.50% | 518,000 60 Acres (38) (401,000 square feet and 49 acres are owned by CP Venture Two LLC) | 100% | 100% | Target (35) | N/A | $ 56,970 |
| | | | | | | Babies R Us (2012/2032) | 50,275 | $ 46,330 |
| | | | | | | Media Play (2010/2025) | 48,884 | |
| | | | | | | Marshalls (2010/2025) | 40,000 | |
| | | | | | | Rhodes (2011/2021) | 40,000 | |
| | | | | | | Linens N Things (2005/2025) | 35,000 | |
| | | | | | | United Artists (2014/2034) | 34,733 | |
| | | | | | | Circuit City (2015/2030) | 33,420 | |
| | | | | | | PETsMART (2009/2029) | 25,465 | |
| | | | | | | Gap s Old Navy Store (2006/2011) | 20,000 | |

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| | Year Development Completed or Acquired | Venture Partner | Company's Ownership Interest | Rentable Square Feet and Acres | Percentage Leased as of December 31, 2003 | Average 2003 Economic Occupancy | Major Tenants (lease expiration/options expiration) | Major Tenants' Rentable Sq. Feet | Adjusted Cost and Adjusted Cost Less Depreciation and Amortization (1) | D Ba |
|---|---|---|---|---|---|---|---|---|---|---|
| ***rs*** | | | | | | | | | | |
| arketCenter VA | 1996 | Prudential (3) | 11.50% | 493,000 | 100% | 99% | Target (35) | N/A | $ 49,105 | $ |
| | | | | 44 Acres (376,000 square feet and 36 acres are owned by CP Venture Two LLC) | | | Harris Teeter, Inc. (2016/2036) | 51,806 | $ 40,035 | |
| | | | | | | | Best Buy (2015/2030) | 45,106 | | |
| | | | | | | | Bed, Bath & Beyond (2012/2027) | 40,484 | | |
| | | | | | | | Babies R Us (2006/2021) | 40,000 | | |
| | | | | | | | Stein Mart, Inc. (2006/2026) | 36,000 | | |
| | | | | | | | Barnes & Noble Superstores, Inc. (2012/2022) | 29,974 | | |
| | | | | | | | PETsMART (2011/2031) | 26,040 | | |
| | | | | | | | Office Max (2011/2026) | 23,484 | | |
| | | | | | | | Gap s Old Navy Store (2007/2012) | 14,000 | | |
| arketCenter , CA | 1996 | Prudential (3) | 11.50% | 182,000 | 100% | 100% | Sears (35) | N/A | $ 32,818 | $ |
| | | | | 19 Acres (157,000 square feet and 17 Acres are owned by CP Venture | | | Circuit City (3)(2017/2037) | 38,541 | $ 27,560 | |
| | | | | | | | Borders, Inc. (2017/2037) | 30,000 | | |
| | | | | | | | Bristol Farms (3)(2012/2032) | 28,200 | | |
| | | | | | | | CompUSA, Inc. (2011/2021) | 25,620 | | |
| | | | | | | | Sav-on Drugs (3)(2016/2036) | 16,914 | | |

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | Two LLC) | | | | | | |
| ssing Phase II tlanta, GA | 1996 | Prudential (3) | 11.50% | 103,000 13 Acres | 100% | 97% | Bed, Bath & Beyond (2012/2027) Ross Stores Inc (2014/2034) Rooms To Go (2016/2036) | 40,787 32,144 21,000 | $ 12,639 $ 10,428 | $ |
| ***Retail Sites Adjacent to Company s Office and Retail Projects*** | | | | | | | | | | |
| ffice Park tlanta, GA | 1985-1993 | IBM | 50% | 14 Acres | 100% | 100% | N/A | N/A | $ 7,616 | $ |
| | | | | | | | | | $ 5,318 | |
| tlanta, GA | 1993 | N/A | 100% | 24 Acres | 100% | 100% | N/A | N/A | $ 3,697 | $ |
| | | | | | | | | | $ 3,467 | |

(1) Cost as shown in the accompanying table includes deferred leasing costs and other related assets. For each of the following projects; 2300 and 2500 Windy Ridge Parkway, 3200 Windy Hill Road, 4100 and 4300 Wildwood Parkway, 4200 Wildwood Parkway and Wildwood Stand Alone Retail Lease Sites, the cost shown is what the cost would be if Wildwood Associates land cost were adjusted downward to the Company s lower basis in the land it contributed to Wildwood Associates.

(2) Approximately .18 acres of the total 4 acres of land at Inforum is under a ground lease expiring 2068.

(3) Actual tenant or venture partner is affiliate of entity shown.

(4) Lockwood Greene Engineers, Inc. has filed for bankruptcy protection and terminated its lease effective February 15, 2004.

(5) Includes acreage and cost of land available for future development. See Land Held for Investment or Future Development.

(6) 103,656 square feet of this lease of 101 Independence Center expires in 2010. Additionally, the tenant has the right to terminate its space in full floor increments beginning in 2005 with 18 months notice.

(7) 3,060 square feet of this lease of 101 Independence Center expires in 2004.

(8) Project was under construction and/or in lease-up as of December 31, 2003. In certain situations, lease expiration dates are based upon estimated commencement dates and square footage is estimated.

(9) This project is owned in a joint venture where the partner or an additional third party may receive a share of the results of the operations or sales proceeds.

(10) 333 John Carlyle and 1900 Duke Street were financed together as one non-recourse mortgage note payable. Until certain events occur, this mortgage note is cross-collateralized with the note referred to in Note 13.

(11) The Company developed 100 and 200 North Point Center East in the years shown. The Company sold these properties to CP Venture Two LLC in 1998 and re-purchased them in 2003.

(12) 100 North Point Center East and 200 North Point Center East were financed together as one non-recourse mortgage note payable.

(13) 333 North Point Center East and 555 North Point Center East were financed together as one non-recourse mortgage note payable. Until certain events occur, this mortgage note is cross-collateralized with the note referred to in Note 10.

(14) 36,331 square feet of the Wachovia lease expires in 2004.

(15) Not included in the leased rentable square feet are 5,448 square feet currently subleased from Chevron to 2005 and 7,208 square feet subleased from Life Office Management Associates to 2005 at which time both spaces will be directly leased to Manhattan Associates and added to their leased square feet through their lease term.

(16) 26,778 square feet of this lease of 3200 Windy Hill Road expires in 2004 and 18,851 square feet of this lease of 3200 Windy Hill Road expires in 2006.

(17) The lease with General Electric at 3200 Windy Hill Road has expired and is currently in negotiation for extension.

(18) IBM exercised its right to terminate this lease at 3200 Windy Hill Road in 2004.

(19) Georgia-Pacific Corporation has the right to terminate its lease in 2007, upon payment of a cancellation penalty. Additionally, Georgia-Pacific Corporation has the option to purchase the building on its lease expiration date for a price of $33,750,000.

(20) The 3100 Windy Hill Road building was sold in 1983 to a third party, subject to a leasehold mortgage note with the Company and a ground lease of the underlying land. In 1997, it was determined that the Company received all the economic rights and rewards of ownership of the property, and 3100 Windy Hill Road has been accounted for as a consolidated property since that time. See Additional Information Related to

Operating Properties following this table.

(21) With respect to the debt related to Bank of America Plaza, see Note 4 of Notes to Consolidated Financial Statements included herein for more information.

(22) Hunton & Williams has the right to terminate its lease at Bank of America Plaza in 2007, upon 36 months notice and payment of a termination fee.

(23) Paul Hastings has a cancellation right on 12,812 square feet and 20,574 square feet of this lease of Bank of America Plaza in 2005 and 2006, respectively.

(24) UBS PaineWebber has the right to terminate its lease in 2008, upon payment of a cancellation penalty.

(25) Mirant Corporation filed for bankruptcy protection in 2003. In January 2004, the Mirant Corporation lease was renegotiated to reduce the amount of its leased space, the term of the lease, and the rental rate. These reductions are not reflected in this table.

(26) Domtar has the right to terminate its lease in 2004 with six months notice.

(27) Charles Schwab & Co., Inc. has the right to terminate its lease with respect to two floors or all of the space in Building IV in 2009, upon 14 months notice and payment of a termination fee. There is no right to early termination for Building III.

(28) Northside/Alpharetta I and II are located on 1 acre and 2 acres subject to ground leases, which expire in 2059.

(29) 4,716 square feet, 12,532 square feet and 4,716 square feet of this lease of Northside/Alpharetta I expire in 2005, 2009 and 2011, respectively.

(30) 17,444 square feet and 10,754 square feet of this lease of Northside/Alpharetta II expire in 2009 and 2011, respectively.

(31) 8,718 square feet of the Northside Hospital lease expires in 2008; 7,521 square feet of the Scottish Rite Hospital lease expires in 2009.

(32) Emory Crawford Long Medical Office Tower was developed on top of a building within the Crawford Long Hospital campus. The Company received a fee simple interest in the air rights above this building in order to develop the medical office tower.

(33) Presbyterian Medical Plaza at University is located on 1 acre which is subject to a ground lease expiring in 2057.

(34) Novant Health, Inc. has the option to renew 23,359 square feet of this lease of Presbyterian Medical Plaza at University through 2027, with the option to renew the balance through 2022.

(35) This anchor tenant owns its own space and land.

(36) Belk, Inc. will build and own its own store and pay the Company under a ground lease.

(37) The Avenue West Cobb and The Shops of Lake Tuscaloosa became partially operational for financial reporting purposes in October 2003 and December 2003, respectively. Thus, economic occupancy does not include a full year of operations.

(38) North Point MarketCenter includes approximately 4 outparcels which are ground leased to freestanding users.

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***Additional Information Related to Operating Properties***

In addition, the 3100 Windy Hill Road building, a 188,000 rentable square foot corporate training facility, occupies a 13-acre parcel of land which is wholly owned by the Company. The training facility improvements were sold in 1983 to a limited partnership of private investors, at which time the Company received a leasehold mortgage note. The training facility land was simultaneously leased to the partnership for thirty years, along with certain equipment for varying periods. The training facility had been leased by the partnership to IBM through November 30, 1998.

Effective January 1, 1997, the IBM lease was extended eight years beyond its previous expiration, to November 30, 2006. Based on the economics of the lease, the Company will receive substantially all of the economic risks and rewards from the property through the term of the IBM lease. In addition, the Company will receive substantially all of the future economic risks and rewards from the property beyond the IBM lease because of the short term remaining on the land lease (seven years as of January 1, 1997) and the large mortgage note balance ($25.9 million as of January 1, 1997) that would have to be paid off, with interest, in that seven-year period before the limited partnership would receive any significant benefit. Therefore, effective January 1, 1997, the $17,005,000 balance of the mortgage note and land was reclassified to Operating Properties, and revenues and expenses (including depreciation) from that point forward have been recorded as if the building were owned by the Company.

***Residential Lots Under Development***

As of December 31, 2003, CREC, Temco Associates and CL Realty, L.L.C. owned the following parcels of land which are being developed into residential communities. Information in the table represents total amounts for the development as a whole, not the Company s share ($ in thousands):

| Description | Initial Year Acquired | Estimated Total Lots to be Developed (1) | Lots Sold to Date | Remaining Lots | Carrying Value | Debt Balance |
|---|---|---|---|---|---|---|
| **CREC** | | | | | | |
| The Lakes at Cedar Grove<br>Fulton County<br>Suburban Atlanta, GA | 2001 | 906 | 316 | 590 | $ 12,011 | $ 900 |
| Longleaf at Callaway (2)<br>Harris County<br>Pine Mountain, GA | 2002 | 138 | 19 | 119 | 4,333 | 1,653 |
| River s Call<br>East Cobb County<br>Suburban Atlanta, GA | 1971-1989 | 107 | 25 | 82 | 6,152 | |
| Total CREC | | 1,151 | 360 | 791 | $ 22,496 | $ 2,553 |
| **Temco Associates (3)** | | | | | | |
| | 1998 | 1,660 | 1,190 | 470 | $ 9,761 | $ |

| | | | | | | |
|---|---|---|---|---|---|---|
| Bentwater<br>Paulding County<br>Suburban Atlanta, GA | | | | | | |
| The Georgian (75% owned)<br>Paulding County<br>Suburban Atlanta, GA | 2003 | 1,386 | 13 | 1,373 | 15,213 | 6,322 |

(Table Continued)

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| Description | Initial Year Acquired | Estimated Total Lots to be Developed (1) | Lots Sold to Date | Remaining Lots | Carrying Value | Debt Balance |
|---|---|---|---|---|---|---|
| Seven Hills at Bentwater Paulding County Suburban Atlanta, GA | 2003 | 1,084 | | 1,084 | 7,344 | |
| Total Temco Associates | | 4,130 | 1,203 | 2,927 | $ 32,318 | $ 6,322 |
| **CL Realty, L.L.C. (3)** | | | | | | |
| Creekside Oaks Manatee County Bradenton, FL | 2003 | 305 | | 305 | $ 3,124 | $ |
| Hidden Lakes Tarrant County Dallas, TX | 2003 | 89 | 41 | 48 | 2,120 | |
| Long Meadow Farms (37.5% owned) Fort Bend County Houston, TX | 2003 | 2,707 | | 2,707 | 4,505 | 1 |
| Manatee River Plantation Manatee County Tampa, FL | 2003 | 460 | | 460 | 4,423 | |
| McKinney Village Park (60% owned) Collin County McKinney, TX | 2003 | 564 | | 564 | 11,503 | 7,298 |
| Stillwater Canyon Dallas County DeSota, TX | 2003 | 336 | 22 | 314 | 5,405 | |
| Stonebridge (10% owned) Coweta County Newnan, GA | 2003 | 622 | | 622 | 7,549 | 5,400 |
| Summer Creek Ranch Dallas County Dallas, TX | 2003 | 2,508 | 128 | 2,380 | 24,862 | |
| Summer Lakes Fort Bend County Rosenberg ,TX | 2003 | 1,160 | | 1,160 | 5,675 | |
| Total CL Realty, L.L.C. | | 8,751 | 191 | 8,560 | $ 69,166 | $ 12,699 |

(1) This estimate represents the total projected development capacity for a development on both owned land and land expected to be purchased for future development. The numbers shown include lots currently developed or to be developed over time, based on management s current estimates, and lots sold to date from inception of development.

(2) Longleaf at Callaway lots are sold to Pine Mountain Builders, LLC, in which CREC is a joint venture partner. As a result of this relationship, the Company recognizes profits when houses are built and sold, rather than at the time lots are sold, as is the case with the Company s other residential developments. As of December 31, 2003, no houses have been sold. See Note 5 to the Company s 2003 Annual Report to Stockholders for more information on Pine Mountain Builders, LLC.

(3) CREC owns 50% of both Temco Associates and CL Realty, L.L.C. ( CL Realty ). See Note 5 to the Company s 2003 Annual Report to Stockholders for a description of Temco Associates and CL Realty.

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***Land Held for Investment or Future Development***

As of December 31, 2003, the Company owned or controlled the following significant land holdings either directly or indirectly through venture arrangements. The holdings were not subject to any debt. The Company evaluates its land holdings on a regular basis and may convert these land holdings to income-producing assets or may sell portions of the land holdings if opportunities arise at favorable prices before development is feasible. See Note 5 for further information related to investments in unconsolidated joint ventures.

| Description, Location and Zoned Use | Year Acquired | Developable Land Area (1) | Joint Venture Partner | Company s Ownership Interest | Adjusted Cost ($ in thousands) |
|---|---|---|---|---|---|
| Wildwood Land | | | | | |
| Suburban Atlanta, Georgia | | | | | |
| Office and Commercial | 1971-1989 | 68 | N/A | 100% | $ 4,292 |
| Office and Commercial | 1971-1982 | 32 | IBM | 50% | $ 7,886(2) |
| North Point Land | | | | | |
| (Georgia Highway 400 & Haynes Bridge Road) (3) | | | | | |
| Suburban Atlanta, Georgia | | | | | |
| Office and Commercial East | 1970-1985 | 13 | N/A | 100% | $ 956 |
| Office, Commercial and Residential West | 1970-1985 | 174 | N/A | 100% | $ 6,632 |
| Ridenour Land | | | | | |
| Suburban Atlanta, Georgia | | | | | |
| Office and Commercial | 2002 | 8 | N/A | 100% | $ 2,595 |
| Salem Road Station | | | | | |
| Suburban Atlanta, Georgia | | | | | |
| Retail Outparcel | 2000 | 2 | N/A | 100% | $ 286 |
| The Avenue West Cobb | | | | | |
| Suburban Atlanta, GA | | | | | |
| Residential (4) | 2003 | 8 | N/A | 100% | $ 2,188 |
| The Shops of Lake Tuscaloosa | | | | | |
| Tuscaloosa, AL | | | | | |
| Retail Outparcel | 2002 | 1 | N/A | 100% | $ 486 |
| Temco Associates | | | | | |
| (Paulding County) | | | | | |
| Suburban Atlanta, Georgia | 1991 | (5) | Temple-Inland Inc. (6) | 50% | $ 584 |

(1) In acres, based upon management s current estimates.

(2) For the portion of the Wildwood Office Park land owned by a joint venture, the cost shown is what the cost would be if the venture s land cost were adjusted downward to the Company s lower basis in the land it contributed to the venture. The adjusted cost excludes building predevelopment costs, net, of $1,006,000.

(3) The North Point property is located both east and west of Georgia Highway 400. The land located east of Georgia Highway 400 surrounds North Point Mall, a 1.3 million square foot regional mall on a 100-acre site

which the Company sold in 1998. Development had been mainly concentrated on the land located east of Georgia Highway 400, until July 1998 when the Company commenced construction of the first building, AtheroGenics, on the west side. The land on the west side has been rezoned to mixed use to include residential as well as office and commercial. The Company sold 42 acres of land on the west side in December 2003.

(4) The Company currently plans to rezone this land at the appropriate time in the future.

(5) Temco Associates has an option through March 2006, with no carrying costs, to acquire the fee simple interest in approximately 7,100 acres in Paulding County, Georgia (northwest of Atlanta, Georgia). The partnership also has an option to acquire interests in a timber rights only lease covering approximately 22,000 acres. This option also expires in March 2006, with the underlying lease expiring in 2025. The options may be exercised in whole or in part over the option period, and the option price of the fee simple land was $1,173 per acre at January 1, 2004, escalating at 6% on January 1 of each succeeding year during the term of the option. The following is a detail of acreage activity:

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| | 2003 | 2002 | 2001 |
|---|---|---|---|
| Acres purchased and simultaneously sold | 97 | 607 | 359 |
| Acres purchased and held under option for third parties | | 78 | 128 |
| Acres held under option subsequently sold | 10 | | |
| Acres purchased by Temco for residential development | 21 | 910 | |
| Acres purchased for sale or future development | 149 | | |
| Total option acres exercised | 277 | 1,595 | 487 |

(6) Joint venture partner is an affiliate of the entity shown.

In addition, the Company owned, directly or indirectly, the following land parcels located adjacent to operating properties discussed above. The basis of each of these building pads is included in the basis of the operating properties in the Company s consolidated financial statements or the applicable joint venture s financial statements.

| | Potential Office Building Square Footage |
|---|---|
| Ten Peachtree Place (1) | 400,000 |
| 101 Independence Center | 400,000 |
| One Georgia Center | 300,000 |
| Austin Research Park (2) | 175,000 |
| The Points at Waterview | 60,000 |

(1) Owned by Ten Peachtree Place Associates

(2) Owned by CPI/FSP I, L.P.

***Other Investments***

*One Ninety One Peachtree Tower.* One Ninety One Peachtree Tower is a 50-story office tower located in downtown Atlanta, Georgia, which contains 1.2 million rentable square feet.

C-H Associates, Ltd. ( C-H Associates ), a partnership formed in 1988 between CREC (49%), Hines Peachtree Associates Limited Partnership (49%) and Peachtree Palace Hotel, Ltd. (2%), owns a 20% interest in the partnership that owns One Ninety One Peachtree Tower. In December 2002, CREC contributed its interest in C-H Associates to Cousins Texas LLC, an entity which is 76% owned by the Company and 24% owned by CREC. C-H Associates 20% ownership of One Ninety One Peachtree Tower results in an effective 9.8% ownership interest by Cousins Texas LLC, subject to a preference in favor of the majority partner, in the One Ninety One Peachtree Tower project. C-H Associates is accounted for under the equity method of accounting for investments in unconsolidated joint ventures. The balance of the One Ninety One Peachtree Tower project is currently owned by Equity Office Properties Trust ( EOP ).

The equity contributed is entitled to a preferred return, with EOP receiving a significant preferred return. After EOP recovers its preferred return, the partners share in any operating cash flow distributions in accordance with their percentage interests. The Company has not recognized any income from its share of the operations of One Ninety One Peachtree Tower to date.

*Air Rights Near the CNN Center.* The Company owns a leasehold interest in the air rights over the approximately 365,000 square foot CNN Center parking facility in Atlanta, Georgia, adjoining the headquarters of Turner Broadcasting System, Inc. and Cable News Network. The air rights are developable for additional parking or office use. The Company s net carrying value of this interest is $0.

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**Supplemental Financial and Leasing Information**

Depreciation and amortization include the following components for the years ended December 31, 2003 and 2002 ($ in thousands):

| | 2003 | | | 2002 | | |
|---|---|---|---|---|---|---|
| | Consolidated | Share of Unconsolidated Joint Ventures | Total | Consolidated | Share of Unconsolidated Joint Ventures | Total |
| Furniture, fixtures and equipment | $ 2,485 | $ 34 | $ 2,519 | $ 2,122 | $ 9 | $ 2,131 |
| Specifically identifiable intangible assets | 26 | | 26 | 26 | | 26 |
| Building (including tenant first generation) | 46,838 | 19,709 | 66,547 | 43,686 | 17,762 | 61,448 |
| Tenant second generation | 2,935 | 1,556 | 4,491 | 2,199 | 778 | 2,977 |
| Discontinued operations | 1,871 | | 1,871 | 6,354 | | 6,354 |
| | $ 54,155 | $ 21,299 | $ 75,454 | $ 54,387 | $ 18,549 | $ 72,936 |

Exclusive of new developments and purchases of furniture, fixtures and equipment, the Company had the following capital expenditures for the years ended December 31, 2003 and 2002, including its share of unconsolidated joint ventures ($ in thousands):

| | 2003 | | | 2002 | | |
|---|---|---|---|---|---|---|
| | Office | Retail | Total | Office | Retail | Total |
| Second generation related costs | $ 12,357 | $ 992 | $ 13,349 | $ 11,348 | $ 456 | $ 11,804 |
| Building improvements | 938 | 220 | 1,158 | 888 | 296 | 1,184 |
| Total | $ 13,295 | $ 1,212 | $ 14,507 | $ 12,236 | $ 752 | $ 12,988 |

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## Item 3. Legal Proceedings

The Company is subject to various legal proceedings, claims and administrative proceedings arising in the ordinary course of business, some of which are expected to be covered by liability insurance and all of which collectively are not expected to have a material adverse effect on the liquidity, results of operations, business or financial condition of the Company.

## Item 4. Submission of Matters to a Vote of Security Holders

No matter was submitted for a vote of the security holders during the fourth quarter of the Registrant s fiscal year ended December 31, 2003.

## Item X. Executive Officers of the Registrant

The Executive Officers of the Registrant as of March 12, 2004 were as follows:

| Name | Age | Office Held |
|---|---|---|
| Thomas G. Cousins | 72 | Chairman of the Board of Directors |
| Thomas D. Bell, Jr. | 54 | President, Chief Executive Officer and Vice Chairman of the Board of Directors |
| Daniel M. DuPree | 57 | Vice Chairman of the Company |
| R. Dary Stone | 50 | Vice Chairman of the Company |
| Tom G. Charlesworth | 54 | Executive Vice President, Chief Financial Officer and Chief Investment Officer |
| James A. Fleming | 45 | Senior Vice President, General Counsel and Secretary |
| Craig B. Jones | 52 | Senior Vice President and President of the Office Division |
| John S. McColl | 41 | Senior Vice President - Office Division |
| Joel T. Murphy | 45 | Senior Vice President and President of the Retail Division |

Family Relationships:

Lillian C. Giornelli, Mr. Cousins daughter, is a director of the Company. Hugh L. McColl, Jr., John S. McColl s father, is a director of the Company. There are no other family relationships among the Executive Officers or Directors.

Term of Office:

The term of office for all officers expires at the annual stockholders meeting. The Board retains the power to remove any officer at any time.

Business Experience:

Mr. Cousins has served as Chairman of the Board of the Company since inception. He was also the Chief Executive Officer of the Company from inception until January 2002. Mr. Cousins is also Director Emeritus of Total System Services, Inc.; Trustee Emeritus of Emory University; Trustee of the High Museum of Art; Member of the Board of Georgia Research Alliance and Chairman and Trustee of the CF Foundation.

Mr. Bell has served as the President and Chief Executive Officer of the Company since January 2002. He is also Vice Chairman of the Board and Chairman of the Executive Committee, having served in these capacities since June 2000. He was a Special Limited Partner with Forstmann Little & Co. from January 2001 until January 2002. He was Worldwide Chairman and Chief Executive Officer of Young & Rubicam, Inc. from January 2000 to November 2000;

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President and Chief Operating Officer of Young & Rubicam, Inc. from August 1999 to December 1999; and Chairman and Chief Executive Officer of Young & Rubicam Advertising from September 1998 to August 1999. He was President and Chief Executive Officer of Burson-Marsteller from May 1995 to September 1998. Mr. Bell is also a director of Lincoln National Corporation, Credit Suisse Group, Regal Entertainment Group, AGL Resources, Inc. and the United States Chamber of Commerce.

Mr. DuPree rejoined the Company in March 2003 as Vice Chairman of the Company. During his previous tenure with the Company from October 1992 until March 2001, he became Senior Vice President in April 1993, Senior Executive Vice President in April 1995 and President and Chief Operating Officer in November 1995. From September 2002 until February 2003, Mr. DuPree was Chief Executive Officer of Barry Real Estate Companies, a privately held development firm.

Mr. Stone joined the Company in June 1999 as President of Cousins Stone LP, a venture in which the Company purchased a 50% interest in June 1999. In July 2000, the Company purchased an additional 25% interest in Cousins Stone LP and in February 2001, the Company purchased the remaining 25% interest. The name Cousins Stone LP was changed to Cousins Properties Services LP in August 2001. Mr. Stone was President and Chief Operating Officer of the Company from February 2001 to January 2002 and has been a Director of the Company since 2001. Effective January 2002, he relinquished the positions of President and Chief Operating Officer and assumed the position of President Texas. In February 2003, he became Vice Chairman of the Company. Since at least January 1999, he was founder and President of the predecessor to Cousins Stone LP, Faison-Stone.

Mr. Charlesworth joined the Company in October 1992 and became Senior Vice President, Secretary and General Counsel in November 1992 and Executive Vice President and Chief Investment Officer in January 2001. He became Chief Financial Officer in February 2003. Prior to 1992, he worked for certain affiliates of Thomas G. Cousins as Chief Financial Officer and Legal Counsel.

Mr. Fleming joined the Company in July 2001 as Senior Vice President, General Counsel and Secretary. He was a partner in the Atlanta law firm of Fleming & Ray from October 1994 until July 2001. Prior to that he was a partner at Long, Aldridge & Norman, where he served as Managing Partner from 1991 through 1993.

Mr. Jones joined the Company in October 1992 and became Senior Vice President in November 1995 and President of the Office Division in September 1998. From 1987 until joining the Company, he was Executive Vice President of New Market Companies, Inc. and affiliates.

Mr. McColl joined the Company in April 1996 as Vice President of the Office Division. He was promoted in May 1997 to Senior Vice President. Prior to that, he was President of Hutchinson Capital Group, Inc. and an officer of Quest Capital Corp.

Mr. Murphy joined the Company in October 1992 and became Senior Vice President of the Company and President of the Retail Division in November 1995. From 1988 to 1990 he was Vice President of New Market Companies, Inc. and affiliates and from 1990 to 1992 he was Senior Vice President of New Market Companies, Inc. and affiliates.

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## PART II

### Item 5.Market for Registrant s Common Stock and Related Stockholder Matters

The high and low sales prices for the Company s common stock and cash dividends declared per common share were as follows:

| | 2003 Quarters | | | | 2002 Quarters | | | |
|---|---|---|---|---|---|---|---|---|
| | **First** | **Second** | **Third** | **Fourth** | First | Second | Third | Fourth |
| High | **$ 26.30** | **$ 28.40** | **$ 30.19** | **$ 31.11** | $ 27.18 | $ 27.32 | $ 25.02 | $ 24.89 |
| Low | **22.95** | **25.85** | **27.15** | **27.68** | 23.70 | 24.20 | 20.05 | 20.23 |
| Dividends Declared: | | | | | | | | |
| Regular | **.37** | **.37** | **.37** | **.37** | .37 | .37 | .37 | .37 |
| Special | | | **2.07** | | | | | |
| Payment Date: | | | | | | | | |
| Regular | **2/24/03** | **5/30/03** | **8/25/03** | **12/22/03** | 2/22/02 | 5/30/02 | 8/26/02 | 12/20/02 |
| Special | | | **9/22/03** | | | | | |

The Company s common stock trades on the New York Stock Exchange (ticker symbol CUZ). At February 20, 2004, there were 1,094 common stockholders of record.

### Item 6.Selected Financial Data

Selected financial data of the Company as of and for the years ended December 31, 2003, 2002, 2001, 2000 and 1999 are as follows (in thousands, except for per share amounts):

| | **2003** | 2002 | 2001 | 2000 | 1999 |
|---|---|---|---|---|---|
| Rental property revenues | **$ 101,389** | $ 97,290 | $ 94,281 | $ 76,340 | $ 48,617 |
| Development, management, leasing and other fees | **18,380** | 18,235 | 19,489 | 10,700 | 13,899 |
| Residential lot and outparcel sales | **12,945** | 9,126 | 6,682 | 13,951 | 17,857 |
| Interest and other | **3,940** | 4,393 | 6,061 | 5,995 | 3,588 |
| Total revenues | **136,654** | 129,044 | 126,513 | 106,986 | 83,961 |
| Rental property operating expenses | **32,674** | 30,613 | 30,505 | 23,744 | 15,166 |
| Depreciation and amortization | **39,477** | 36,302 | 32,790 | 24,181 | 14,028 |
| Residential lot and outparcel cost of sales | **10,022** | 7,309 | 5,910 | 11,684 | 14,897 |
| Interest expense | **22,576** | 27,041 | 17,852 | 7,680 | (215) |
| Loss on debt extinguishment | | 3,501 | | | |
| General, administrative and other expenses | **33,664** | 31,521 | 29,614 | 22,537 | 18,218 |
| Total expense | **138,413** | 136,287 | 116,671 | 89,826 | 62,094 |
| (Provision) benefit for income taxes from operations | **(2,596)** | (1,526) | 691 | 1,145 | (2,442) |

| | | | | | |
|---|---|---|---|---|---|
| Income from unconsolidated joint ventures | **24,619** | 26,670 | 22,897 | 19,452 | 19,637 |
| Gain on sale of investment properties, net of applicable income tax provision | **100,558** | 6,254 | 23,496 | 11,937 | 58,767 |
| Income from continuing operations | **120,832** | 24,155 | 56,926 | 49,694 | 97,829 |
| Discontinued operations | **121,339** | 23,717 | 13,889 | 12,915 | 6,253 |
| Cumulative effect of change in accounting principle | | | | (566) | |
| Preferred dividends | **(3,358)** | | | | |
| Net income available to common stockholders | **$ 238,803** | $ 47,872 | $ 70,815 | $ 62,043 | $ 104,082 |
| Basic net income per common share | **$ 4.94** | $ .97 | $ 1.44 | $ 1.28 | $ 2.16 |
| Diluted net income per common share | **$ 4.83** | $ .96 | $ 1.41 | $ 1.25 | $ 2.12 |
| Cash dividends declared per common share | **$ 3.55** | $ 1.48 | $ 1.39 | $ 1.24 | $ 1.12 |
| Total assets | **$ 1,140,414** | $ 1,248,077 | $ 1,216,629 | $ 1,115,752 | $ 932,925 |
| Notes payable | **$ 497,981** | $ 669,792 | $ 585,275 | $ 485,085 | $ 312,257 |
| Stockholders investment | **$ 578,777** | $ 408,884 | $ 462,673 | $ 454,467 | $ 437,722 |
| Common shares outstanding at year-end | **48,835** | 48,386 | 49,425 | 49,210 | 48,261 |

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## Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations

The accompanying Management s Discussion and Analysis of Financial Condition and Results of Operations has been updated to reflect the restatement discussed in Note 10 to the Consolidated Financial Statements.

**General.** Historically, the Company s financial results have been significantly affected by sale transactions and the fees generated by, and start-up operations of, major real estate developments, which transactions and developments do not necessarily recur. Accordingly, the Company s historical financial statements may not be indicative of future operating results. The notes referenced in the discussion below are the Notes to Consolidated Financial Statements included in this Annual Report.

**2003 Highlights.**

Sold four properties for $258.6 million, generating Gain on Sale of Investment Properties for Discontinued Operations of $93.5 million.

Recognized Gain on Sale of Investment Properties of $90.0 million, which was previously deferred, upon distribution of proceeds from the aforementioned sale of one of the properties.

Paid a special dividend of $100.5 million, or $2.07 per share, to common stockholders as a result of proceeds from aforementioned property sales.

Completed a preferred stock offering which generated net proceeds of $96.3 million.

Sold approximately 53 acres of land held for investment for net gains totaling $7.3 million.

Opened The Avenue West Cobb and The Shops of Lake Tuscaloosa.

Commenced development of The Avenue Viera and 11 new residential developments, including developments owned in joint ventures.

Acquired 100 and 200 North Point Center East for assumption of approximately $22.4 million of debt in December 2003.

Received $24.7 million of lease termination fees while maintaining a 91% overall leased percentage at December 31, 2003.

**Overview of 2003 Performance and Company and Industry Trends.** In 2003 the Company continued to experience weakness in its office tenant base, with a number of early lease terminations. While this generated substantial one-time termination fees in 2003, management believes that it presents leasing challenges going forward. We expect that these terminations will impact revenues from our Office Division in 2004. Although the Company s office portfolio closed the year at an average leased level of 91%, significant vacancy does exist in all of the major office markets, and the Company believes it will take several years for these markets to return to healthy vacancy numbers. The Company believes that market indicators for the economy show improvement. The Company also believes that job growth, a critical factor for office demand, is returning, especially in our most important market of Atlanta. Reported job growth in Atlanta has been among the highest in the nation. Management believes that deterioration in its office markets may be subsiding and that they could begin to improve in 2004.

While office supply and demand fundamentals generally were weak in 2003, quality office and retail assets continued to garner attractive pricing in sales transactions. Management believes this is due to real estate gaining

greater investor acceptance, both from institutional investors and from private and individual investors. Management believes that this trend will offer support to real estate pricing and REITs in the future. Real estate investment was also positively affected in 2003 by low interest rates that allowed many buyers to obtain more favorable financing terms for properties than in past years.

The Company took advantage of the favorable pricing in the asset markets by selling a number of its properties in 2003. These included several retail assets at attractive prices and some office assets, as well. The Company s primary mission is to create stockholder value through development. These assets had reached values that in management s judgment may not have been sustained. A core principle of the Company is to actively manage its portfolio of properties and to realize value it has created at appropriate times. This value can then be invested in new value creation projects or returned to the stockholders if the Company has sufficient other funds to support future investments. This trend of favorable pricing appears to be continuing in 2004 with favorable pricing being available for a number of the Company s office assets. The Company may sell additional assets, including office assets, in 2004.

In 2003 the Company distributed a $100.5 million, or $2.07 per share, special dividend to its common stockholders following certain asset sales. Management believes that the Company has sufficient other funds and availability to finance its anticipated future investment needs. If the Company does sell additional assets in 2004, it will again consider a special dividend after analyzing its future capital needs.

The Company s fundamental retail business performed well in 2003. There were few tenant problems in the retail portfolio and the Company was able to maintain a leased level of 93%. Management believes it has a strong shadow

pipeline of new potential retail development projects. These include Avenueâ projects, power centers and grocery anchored centers. The Company hopes to begin a number of these projects in 2004.

The Company s Land Division improved in 2003 and increased its contribution to earnings in 2003 as compared to 2002. The Company also added a number of new residential lot development deals to its pipeline, which management expects to contribute to future performance. Management expects this group s contribution to continue to grow in 2004.

**Forward-Looking Statements.** Certain matters contained in this report are forward-looking statements within the meaning of the federal securities laws and are subject to uncertainties and risks. These include, but are not limited to, general and local economic conditions, local real estate conditions, the activity of others developing competitive projects, the cyclical nature of the real estate industry, the financial condition of existing tenants, interest rates, the Company s ability to obtain favorable financing or zoning, environmental matters, the effects of terrorism, the failure of assets under contract for sale to ultimately close, and other risks detailed from time to time in the Company s filings with the Securities and Exchange Commission, including the Company s Current Report on Form 8-K filed on December 10, 2003. The words believes, expects, anticipates, estimates, and similar expressions are intended to identify forward-looking statements. Although the Company believes that its plans, intentions and expectations reflected in any forward-looking statements are reasonable, the Company can give no assurance that such plans, intentions or expectations will be achieved. Such forward-looking statements are based on current expectations and speak as of the date of such statements. The Company undertakes no obligation to publicly update or revise any forward-looking statement, whether as a result of future events, new information or otherwise.

**Critical Accounting Policies.** A critical accounting policy is one which is both important to the portrayal of a company s financial condition and results of operations and requires significant judgment or complex estimation processes. As the Company is in the business of developing, owning and managing office and retail real estate properties and developing single-family residential communities which are parceled into lots and sold to various home builders, its critical accounting policies relate to cost capitalization, impairment of long-lived assets, depreciation and amortization, residential lot and land tract sales profit recognition and valuation of receivables.

The Company expenses predevelopment costs incurred on a potential project until it becomes probable that the project will go forward. After a project becomes probable, all subsequently incurred predevelopment costs, as well as interest, real estate taxes and certain internal personnel and associated costs directly related to the project under development are capitalized. If the project s probability comes into question, a reserve may be placed on the assets. If the decision is made to abandon development of a project that had been deemed probable, all previously capitalized costs are expensed or the project is written off against the reserve, if one was established. Therefore, a change in the probability of a project could result in the expensing of significant costs incurred for predevelopment activity. Furthermore, if a project is developed, a change in the estimated time and cost of construction could adversely impact the return on the project and the amount of value created from the development of the project.

The Company periodically evaluates its real estate assets to determine if there has been any impairment in their carrying values and records impairment losses if the undiscounted cash flows estimated to be generated by those assets are less than the assets carrying amounts. The evaluation of real estate assets involves many subjective assumptions dependent upon future economic events that affect the ultimate value of the property. For example, future cash flows from properties are estimated using expected market rental rates, anticipated leasing results and potential sales results. A change in assumptions concerning future economic events could result in an adverse change in the value of a property and cause an impairment to be recorded. The Company has analyzed all real estate assets that had indicators of impairment and has determined that the carrying value of all real estate assets on the accompanying Consolidated Balance Sheets does not exceed undiscounted cash flows estimated to be generated by those assets, and no impairment losses were required to be recorded. Unconsolidated joint ventures follow the same impairment

assessment as the Company.

Real estate assets are depreciated or amortized over their estimated useful lives using the straight-line method of depreciation. Management uses its judgment when estimating the life of the real estate assets and when allocating the cost of acquired properties. Historical data, comparable properties and replacement costs are some of the factors considered in determining useful lives and cost allocations. If management incorrectly estimates the useful lives of the Company s real estate assets or if cost allocations are not appropriate, then depreciation and amortization may not be reflected properly in the Company s operations.

In its determination of the gross profit percentages to be applied to its residential lot or land tract sales in order to calculate the profits to be recognized on these sales, the Company utilizes several estimates. Gross profit percentages are calculated based on the estimated lot sales prices and the estimated costs of the development or on the estimated total land tract sales and any estimated development or improvement costs. The Company must estimate the prices of the lots or land tracts to be sold, the costs to complete the development of the residential community or the land improvements and the time period over which the lots or land tracts will ultimately be sold. If the Company s estimated lot or land tract sales or costs of development, or the assumptions underlying either, were to be revised or be rendered inaccurate, it would affect the gross profit percentages and overall profit recognized on these sales.

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Receivables, including straight-line rent receivables, are reported net of an allowance for doubtful accounts and may be uncollectible in the future. The Company performs credit reviews and analyses on its tenants and reviews its receivables regularly for potential collection problems in computing the allowance recorded against its receivables. This review process requires the Company to make certain judgments regarding collectibility notwithstanding the fact that ultimate collections are inherently difficult to predict. A change in the judgments made could result in an adjustment to the allowance for doubtful accounts with a corresponding effect to net income.

**Results of Operations For The Three Years Ended December 31, 2003**

**Rental Property Revenues.** Rental property revenues increased from $94,281 in 2001 to $97,290 in 2002 and $101,413 in 2003.

**2003**

Rental property revenues from the Company s office division increased approximately $1,397,000 in 2003. Contributing to the increase in rental property revenues from the office division was an increase of approximately $1,035,000 from The Points at Waterview, as lease-up occurred at the property and average economic occupancy increased from 45% in 2002 to 84% in 2003. Partially offsetting the increase was a decrease in rental property revenues from 333 North Point Center East of approximately $961,000 in 2003 due to a decrease in average economic occupancy from 96% in 2002 to 60% in 2003, as certain tenants leases expired and were not renewed and the space had not yet been re-leased.

Rental property revenues from the Company s retail division increased approximately $2,702,000 in 2003. The Avenue West Cobb became partially operational for financial reporting purposes in October 2003, which contributed approximately $896,000 to the increase. Rental property revenues from The Avenue of the Peninsula increased approximately $722,000 in 2003, mainly due to the recognition of termination fees and percentage rents during the year. Additionally, rental property revenues from The Avenue East Cobb increased approximately $631,000, mainly due to the recognition of termination fees during the year.

**2002**

Rental property revenues from the Company s office division increased approximately $678,000 in 2002. 1900 Duke Street became partially operational in October 2000, which contributed approximately $436,000 to the 2002 increase. Also contributing to the increase in rental property revenues from the office division in 2002 was an increase of approximately $554,000 from Meridian Mark Plaza, as its average economic occupancy increased from 94% in 2001 to 99% in 2002, and an increase of approximately $443,000 from Inforum, primarily due to lease termination fees received from two tenants. Additionally, rental property revenues increased approximately $483,000 from the 3301 Windy Ridge Parkway Building due to the renewal of the single tenant s lease at a higher rental rate beginning May 2001. The increase in rental property revenues was partially offset by a decrease of approximately $1,178,000 from The Points at Waterview, as its average economic occupancy decreased from 73% in 2001 to 45% in 2002.

Rental property revenues from the Company s retail portfolio increased approximately $2,331,000 in 2002. Rental property revenues increased approximately $2,282,000 from The Avenue Peachtree City due both to the property becoming partially operational for financial reporting purposes in April 2001 and to the recognition of a termination fee of approximately $719,000 in 2002. Substantially all of the square feet terminated at The Avenue Peachtree City was re-leased. An increase in the average economic occupancy of The Avenue of the Peninsula from 75% in 2001 to 80% in 2002 also contributed approximately $1,295,000 to the increase in rental property revenues. Rental property revenues decreased approximately $990,000 in 2002 due to the February 2001 sale of Colonial Plaza MarketCenter, which partially offset the increase in rental property revenues.

**Rental Property Operating Expenses.** Rental property operating expenses increased from $30,505,000 in 2001 to $30,613,000 and $32,674,000 in 2002 and 2003, respectively. The increases in both 2002 and 2003 were due primarily to the aforementioned office buildings and retail centers being leased-up or becoming partially operational for financial reporting purposes. The increases in rental property operating expenses were partially offset by approximately $500,000 in 2002 from the aforementioned decrease in average economic occupancy at The Points at Waterview.

**Development Income.** Development income decreased from $6,179,000 in 2001 to $4,625,000 and $2,870,000 in 2002 and 2003, respectively. Development income and tenant construction fees decreased approximately $493,000 in 2003 from the Crawford Long CPI, LLC joint venture, as construction of the Emory Crawford Long Medical Office Tower was substantially completed in February 2002. Development fees from third party projects also decreased approximately $1,426,000 primarily due to the wind down of three significant third party office projects and two retail projects, partially offset by an increase from a third party retail project.

Development income decreased approximately $1,166,000 in 2002 from CPI/FSP I, L.P., as construction of Austin Research Park Buildings III and IV was completed. Development income also decreased approximately $727,000 in 2002 from Crawford Long CPI, LLC, as construction of the Emory Crawford Long Medical Office Tower was substantially completed in February 2002. Additionally, development income decreased approximately $215,000 in 2002 from 285 Venture, LLC, as construction of 1155 Perimeter Center West was completed in 2001. The decrease in development income in 2002 was partially offset by an increase in third party development and advisory services of approximately $687,000.

**Management Fees.** Management fees increased from $7,966,000 in 2001 to $9,313,000 in 2002 and then decreased to $8,519,000 in 2003. Approximately $351,000 of the 2003 decrease related to Cousins Properties Services LP ( CPS ), as a result of decreased contracts for third party office building management services. Management fees also decreased approximately $405,000 due to the loss of the management services of the One Ninety One Peachtree Tower office building.

Approximately $921,000 of the 2002 increase was due to the consolidation of CPS discussed in Note 5. Of this increase, approximately $868,000 was from a new third party contract which CPS obtained in October 2001. Management fees also increased approximately $175,000 in 2002 from Crawford Long CPI, LLC, due to the aforementioned Emory Crawford Long Medical Office Tower becoming partially operational for financial reporting purposes in February 2002.

**Leasing and Other Fees.** Leasing and other fees decreased from $5,344,000 in 2001 to $4,297,000 in 2002 and then increased to $6,991,000 in 2003. Leasing and other fees increased approximately $3,954,000 at CPS in 2003, primarily from an increase in sales of land which CPS brokered. The increase was partially offset by a decrease in leasing fees recognized from unconsolidated joint ventures of approximately $1,292,000 primarily due to two large leases signed in 2002.

The decrease in 2002 is primarily due to a decrease of approximately $1,130,000 from CPI/FSP I, L.P., as leasing fees were recognized for the lease-up of Austin Research Park Buildings III and IV in 2001. Leasing and other fees from CPS decreased approximately $822,000 in 2002 due to decreased sales of land brokered by CPS. The CPS decrease was partially offset by an increase in leasing and other fees of approximately $533,000 from third party contracts and approximately $454,000 from Ten Peachtree Place Associates, due to the lease-up of the Ten Peachtree Place building.

**Residential Lot and Outparcel Sales and Cost of Sales.** Residential lot and outparcel sales increased from $6,682,000 in 2001 to $9,126,000 and $12,945,000 in 2002 and 2003, respectively. Residential lot sales increased due to an increase in the number of lots sold, from 121 lots in 2001 to 166 and 214 lots in 2002 and 2003, respectively. The mix of lots sold at the residential developments also changed between years, with the sales price points being different at the various developments. Additionally, there was one outparcel sale in 2003 for $600,000, one in 2002 for $547,000 and none in 2001.

Residential lot and outparcel cost of sales increased from $5,910,000 in 2001 to $7,309,000 and $10,022,000 in 2002 and 2003, respectively. The increases in residential lot cost of sales were partially due to the increase in the aforementioned changes in lots sold during the periods and partially to fluctuations in gross profit percentages used to calculate the cost of sales for residential lot sales in certain of the residential developments. Furthermore, outparcel cost of sales were approximately $480,000 in 2003 and $353,000 in 2002 due to the aforementioned outparcel sales.

**Interest and Other Income.** Interest and other income decreased from $6,061,000 in 2001 to $4,393,000 and $3,940,000 in 2002 and 2003, respectively. Interest and other income decreased approximately $945,000 in 2003 due to the repayment in August 2003 of the 650 Massachusetts Avenue note receivable. The decrease in 2003 was partially offset by income recognized related to warrants owned by the Company to buy common stock of an unrelated third party.

The decrease in interest and other income in 2002 was primarily due to the $18.6 million note receivable from Gateway, which was repaid in full in November 2001.

**General and Administrative Expenses.** General and administrative expenses increased from $26,734,000 in 2001 to $27,699,000 and $29,606,000 in 2002 and 2003, respectively. The increase in 2003 was primarily due to an

increase in salaries and related benefits, partially offset by an increase in capitalized salaries to projects under development. The increase in 2002 was primarily due to increased salaries and related benefits as a result of the aforementioned consolidation of CPS and new personnel in several business units. Partially offsetting the increase in 2002 was a decrease resulting from the capitalization of additional general and administrative expenses to offset the partial elimination of certain development and leasing fees from joint ventures (see Note 1, Fee Income ).

**Depreciation and Amortization.** Depreciation and amortization increased from $32,790,000 in 2001 to $36,302,000 and $39,477,000 in 2002 and 2003, respectively. The increases in 2003 and 2002 were primarily due to write-offs of unamortized tenant improvements and leasing costs related to certain tenants who effected early terminations of their lease obligations. The 2002 increase also related to the aforementioned office building and retail center becoming partially operational for financial reporting purposes in 2002.

**Interest Expense.** Interest expense increased from $17,852,000 in 2001 to $27,041,000 in 2002 and then decreased to $22,576,000 in 2003. Interest expense of continuing operations before capitalization increased from $27,564,000 in 2001 to $32,975,000 in 2002 and then decreased to $32,260,000 in 2003. The 2003 decrease was partially due to a decrease in interest expense of $1,418,000 related to the Company s credit facility. The credit facility was paid down in part using the proceeds of the July 2003 preferred stock offering and from a portion of the proceeds from the aforementioned property sales. The decrease in interest expense of continuing operations before capitalization in 2003 was partially offset by an increase in interest expense of $877,000 related to the refinancing of the CSC Associates, L.P. note (see Note 4). The amount of interest capitalized (a reduction of interest expense), which changes parallel to the level of projects under development, decreased from $9,712,000 in 2001 to $5,934,000 in 2002 and then increased to $9,684,000 in 2003. Capitalized interest varies as the weighted average expenditures for projects under development changes. Expenditures were higher in 2003 compared to 2002.

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Interest expense of continuing operations before capitalization increased in 2002 due to higher average debt levels, in part from the CSC Associates, L.P. refinancing (see Note 4). Additionally, the Company completed three non-recourse mortgages in 2001 for properties not included in discontinued operations: 600 University Park Place in July 2001, 333 John Carlyle/1900 Duke Street and 333/555 North Point Center East in November 2001, which all contributed a full year of interest to 2002. Partially offsetting the increase in interest expense in 2002 was a reduction in interest on the credit facility due to a decrease in the average floating rate.

**Other Expenses.** Other expenses increased from $2,261,000 in 2001 to $3,147,000 and $3,290,000 in 2002 and 2003, respectively. Both predevelopment expense and minority interest remained relatively flat between 2002 and 2003. The 2002 increase in other expenses was mainly due to an increase of $793,000 in predevelopment expense from 2001.

**(Provision) Benefit for Income Taxes From Operations.** Income taxes from operations increased from a benefit of $691,000 in 2001 to a provision of $1,526,000 in 2002 and increased further to a provision of $2,596,000 in 2003. The increase in 2003 was due to higher income before income taxes and gain on sale of investment properties at CREC and its subsidiaries due to increased residential lot and outparcel sales, net of cost of sales. The increase is also due to an increase in income from CREC II and its subsidiaries, which is now merged into CREC, from increased fees on sales of land partnerships brokered by CPS.

The increase in the tax provision in 2002 was primarily due to an increase in income before income taxes and gain on sale of investment properties from CREC and its subsidiaries. The increase at CREC and its subsidiaries was primarily due to increases in income from residential lot sales, net of cost of sales, and a decrease in general and administrative expenses. The increase at CREC and its subsidiaries was partially offset by a decrease in development income and an increase in interest expense. The increase in the provision for income taxes in 2002 was also due to a decrease in the loss before income taxes and gain on sale of investment properties from CREC II and its subsidiaries. This decrease was mainly due to increased income from CPS.

**Income From Unconsolidated Joint Ventures.** (All amounts reflect the Company s share of joint venture income.) Income from unconsolidated joint ventures increased from $22,897,000 in 2001 to $26,670,000 in 2002 and then decreased to $24,619,000 in 2003.

Income from Wildwood Associates increased from $5,223,000 in 2001 to $6,360,000 in 2002 and then decreased to $4,820,000 in 2003. The 2003 decrease was due to a decrease in rental property revenues at 2300 Windy Ridge Parkway due to a decrease in average economic occupancy from 99% in 2002 to 86% in 2003. Rental property revenues also decreased in 2003 from the 3200 Windy Hill Road Building as its average economic occupancy decreased from 100% in 2002 to 94% in 2003. The decrease at the 3200 Windy Hill Road Building was partially offset by a termination fee received in 2003 from a tenant who exercised their cancellation option. Income from Wildwood Associates also decreased approximately $551,000 in 2003 due to an impairment loss which was recognized when certain land was categorized as held for sale. The ultimate sales price was comparable to the new carrying value. The 2002 increase was primarily due to an increase in rental property revenues from the 3200 Windy Hill Road Building, as its average economic occupancy increased from 99% in 2001 to 100% in 2002 and its tenant mix changed.

The loss from Cousins LORET increased from $54,000 in 2001 to $729,000 in 2002 and then the loss decreased to $153,000 in 2003. The 2003 decrease in loss was due to a decrease in depreciation and amortization of approximately $884,000 in 2003 at Two Live Oak Center. The decrease in depreciation and amortization was partially offset by a decrease in rental property revenues as the average economic occupancy of Two Live Oak Center decreased from 89% in 2002 to 81% in 2003. The increase in loss in 2002 was primarily due to a reduction in the average economic occupancy of Two Live Oak Center from 98% in 2001 to 89% in 2002 and to an increase of approximately $582,000

in depreciation and amortization at Two Live Oak Center, as previously mentioned.

Income from Temco Associates increased from $1,720,000 in 2001 to $1,949,000 and $3,139,000 in 2002 and 2003, respectively. Lots sold at Temco Associates increased from 233 lots in 2001 to 289 and 356 lots in 2002 and 2003, respectively. During 2001, 2002 and 2003, approximately 359, 607 and 97 acres, respectively, of the option related to the fee simple interest were exercised and simultaneously sold. Additionally, in 2003, 10 acres which had previously been exercised under the option were sold. CREC s share of the gain on these and other tract sales was approximately $1,075,000, $668,000 and $472,000 in 2001, 2002 and 2003, respectively.

Income from 285 Venture, LLC increased from $2,596,000 in 2001 to $2,725,000 in 2002 and then decreased to a loss of $845,000 in 2003. The 2003 decrease was due to the underlying tenant, Mirant Corporation ( Mirant ), declaring bankruptcy. Rental property revenues did not change in 2003, but at December 31, 2003, it was probable that the Mirant lease would be renegotiated so as to decrease the amount of space leased. Therefore, the related SFAS No. 13 straight-line rent receivable and the unamortized tenant improvements and leasing costs related to the likely-to-be-vacated space were reserved in 2003. In January 2004, the Mirant lease was renegotiated, as anticipated. Mirant reduced the amount of leased space, the term of its lease and its rental rate. The Company is actively attempting to re-lease the vacated space, but the impact on income from 285 Venture, LLC in 2004 and beyond is not known at this time.

Income of $927,000 from Crawford Long CPI, LLC was first recognized in 2002 as Emory Crawford Long Medical Office Tower became partially operational for financial reporting purposes in February 2002. Income from Crawford Long CPI, LLC decreased to $376,000 in 2003 due to interest expense related to a mortgage note payable obtained by the venture in 2003.

Income from Ten Peachtree Place Associates decreased from $169,000 in 2001 to a loss of $854,000 in 2002, and then increased to income of $531,000 in 2003. The average economic occupancy of Ten Peachtree Place was 93% in 2001, 14% in 2002 and 90% in 2003. The partner in the venture leased the building until November 2001, and after expiration of this lease, the building was re-leased during 2002, with most of the occupancy occurring in 2003.

Income from CL Realty, L.L.C. was $606,000 in 2003. The venture was formed in 2002 and lot development began. Lot sales commenced in 2003 with 191 lots being sold. CL Realty, L.L.C. currently has over 8,000 lots under development in nine different residential projects. These projects are expected to be completed within two to ten years.

Income from CPI/FSP I, L.P. increased from $352,000 in 2001 to $2,119,000 and $2,368,000 in 2002 and 2003, respectively. Austin Research Park Buildings III and IV became partially operational for financial reporting purposes in June 2001 and September 2001, respectively.

Income from the CP Venture LLC entities did not significantly change between 2001 and 2002, but decreased to a loss of $22,000 in 2003. The loss in 2003 was due to an impairment loss recognized at CP Venture Two LLC related to 100 and 200 North Point Center East. (See Note 5 for a description of the Company s interest in CP Venture LLC and CP Venture Two LLC.) 100 and 200 North Point Center East were held for sale properties in 2003, and, as a result, an impairment loss was recorded to reduce the properties to their fair value.

Income from Gateway increased from $620,000 in 2001 to $1,184,000 in 2002 and then decreased to $1,176,000 in 2003. The Company recognizes an 11.46% current preferred return on its equity in Gateway, which increased from $3,200,000 to $10,556,000 in November 2001. Income does not equal the preferred return on the equity due to amortization of capitalized amounts at the Company level.

**Gain on Sale of Investment Properties.** Gain on sale of investment properties, net of applicable income tax provision, was $23,496,000, $6,254,000 and $100,558,000 in 2001, 2002 and 2003, respectively. The 2003 gain included the following: deferred gain due to the distribution of proceeds from the Mira Mesa sale ($90.0 million see Note 5), the September 2003 sale of 10.6 acres of Company-owned Wildwood land ($1.9 million), the December 2003 sale of North Point West Side land ($5.3 million) and the recurring amortization of net deferred gain from the Prudential transaction ($3.3 million see Note 5).

The 2002 gain included the following: the December 2002 sale of 5.5 acres of Company-owned Wildwood land ($2.1 million) and the amortization of net deferred gain from the Prudential transaction ($4.1 million see Note 5).

The 2001 gain included the following: the February 2001 sale of Colonial Plaza MarketCenter ($17.1 million), the February 2001 disposition of leasehold interests at Summit Green ($0.2 million), the December 2001 sale of 7 acres of Wildwood land ($2.0 million) and the amortization of net deferred gain from the Prudential transaction ($4.2 million see Note 5).

**Discontinued Operations.** The Company sold AT&T Wireless Services Headquarters, Cerritos Corporate Center Phase II and Mira Mesa MarketCenter in the second quarter of 2003. The Company sold Presidential MarketCenter and Perimeter Expo in the third quarter of 2003. Subsequent to year-end, The Shops of Lake Tuscaloosa, Northside/Alpharetta I and II, 101 Second Street and 55 Second Street were sold. SFAS No. 144 requires that these

office buildings and retail centers that were sold or are considered held for sale be treated as discontinued operations and that the results of their operations and any gains on sales from these properties be shown as a separate component of income in the Consolidated Statements of Income for all periods presented. See Note 8 for a detail of the components of income from discontinued operations.

Income from discontinued operations increased from $13,889,000 in 2001 to $22,453,000 and $27,880,000 in 2002 and 2003, respectively. A termination fee of $20,000,000 was recognized in 2003 from Cable & Wireless Internet Services, Inc., which terminated its 158,000 square foot lease at 55 Second Street in January 2003. Although the operations of the five properties sold in 2003 were not included in 2003 Discontinued Operations for a full year, the above mentioned termination fee partially offset the loss of income from those properties.

The increase in income from discontinued operations for 2002 was primarily due to 55 Second Street becoming partially operational for financial reporting purposes in February 2002.

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## Liquidity and Capital Resources

**Financial Condition**. The Company s adjusted debt was $498.0 million, or 24% of total market capitalization, at December 31, 2003, and the Company was subject to the following contractual obligations and commitments ($ in thousands):

| | Total | Less Than 1 Year | 1-3 Years | 4-5 Years | After 5 Years |
|---|---|---|---|---|---|
| **Contractual Obligations:** | | | | | |
| Company long-term debt (Note 4): | | | | | |
| Unsecured notes payable | $ 20,698 | $ 1,426 | $ 19,182 | $ 60 | $ 30 |
| Mortgage debt | 477,283 | 8,707 | 26,560 | 84,632 | 357,384 |
| Operating leases (ground leases) | 34,370 | 336 | 694 | 724 | 32,616 |
| Operating leases (offices) | 1,457 | 1,015 | 442 | | |
| Total Contractual Obligations | $ 533,808 | $ 11,484 | $ 46,878 | $ 85,416 | $ 390,030 |
| **Commitments:** | | | | | |
| Letters of credit | $ 9,579 | $ 9,579 | $ | $ | $ |
| Performance bonds | 3,165 | 2,500 | 665 | | |
| Estimated development commitments | 101,762 | 95,762 | 6,000 | | |
| Unfunded tenant improvements | 9,333 | 9,333 | | | |
| Total Commitments | $ 123,839 | $ 117,174 | $ 6,665 | $ | $ |

At December 31, 2003, the Company had no amounts drawn on its $275 million credit facility. The amount available under this credit facility is reduced by outstanding letters of credit. This unsecured credit facility contains customary conditions precedent to borrowing, including compliance with financial covenants such as minimum interest coverage and maximum debt to market capitalization. The interest rate on this facility is equal to LIBOR plus a spread based on the ratio of total debt to total assets. As of December 31, 2003, the spread over LIBOR was 1.15%. This facility also contains customary events of default that could give rise to acceleration and include such items as failure to pay interest or principal and breaches of financial covenants such as maintenance of minimum capitalization and minimum interest coverage. This facility is maturing in August 2004, at which time the Company intends to replace it with a new credit facility. Terms and conditions under this new facility are not known at this time.

The Company s mortgage debt is primarily non-recourse fixed-rate debt secured by various real estate. As of December 31, 2003, the weighted average interest rate on this debt was 7.2%. In addition, many of the Company s non-recourse mortgages contain covenants which, if not satisfied, could result in acceleration of the maturity of the debt. Although not certain at this time, the Company intends to either refinance the non-recourse mortgages if they own the related property at maturity or pay off the mortgages with proceeds of other financings.

The Company has future lease commitments under land leases aggregating approximately $34.4 million over an average remaining term of 60 years. Additionally, the Company has future lease commitments for office space aggregating approximately $1.4 million over an average remaining term of 1.5 years.

As of December 31, 2003, the Company had outstanding letters of credit and performance bonds aggregating approximately $12.7 million. These instruments primarily related to guarantees of maintenance and/or performance

pertaining to the Company s development projects or additional collateral on unsecured corporate notes payable.

The Company has development and acquisition projects in various planning stages. The Company currently intends to finance these projects and projects currently under construction discussed in Note 9, by using its existing credit facility (increasing the credit facility as required), long-term non-recourse financing on the Company s unleveraged projects, joint ventures, project sales and other financings as market conditions warrant. As of December 31, 2003, outstanding commitments for the construction and design of consolidated real estate projects totaled approximately $101.8 million most of which is estimated to be funded in 2004. In addition, the Company was obligated under lease agreements at its operating properties to fund remaining tenant improvement costs of approximately $9.3 million in 2004.

As a member of various of the unconsolidated joint ventures described in Note 5, the Company may be required to make additional capital contributions from time to time to fund development costs, tenant improvement costs or operating deficits. The Company has not guaranteed the debt of any of its unconsolidated joint ventures, except for guarantees of non-recourse carve-outs of mortgages.

In September 1996, the Company filed a shelf registration statement with the Securities and Exchange Commission ( SEC ) for the offering from time to time of up to $200 million of common stock, warrants to purchase common stock and debt securities. Approximately $68 million had previously been drawn on this shelf registration. In July 2003, the Company filed a new and amended shelf registration statement, which provided for the offering from time to time of up to $133 million (increasing the amount available by $1 million) of common stock, warrants to purchase common stock, debt securities and

preferred stock. As described in Note 6, the Company issued $100 million of preferred stock in July 2003. As of December 31, 2003, approximately $33 million remained available for issuance under the new shelf registration statement.

The Company from time to time evaluates opportunities and strategic alternatives, including but not limited to joint ventures, mergers and acquisitions and new private or publicly-owned entities created to hold existing assets and acquire new assets. These alternatives may also include sales of single or multiple assets at appropriate times when the Company perceives opportunities to capture value and redeploy proceeds or distribute proceeds to stockholders. The Company s consideration of these alternatives is part of its ongoing strategic planning process. There can be no assurance that any such alternative, if undertaken and consummated, would not materially adversely affect the Company or the market price of the Company s Common Stock.

**Cash Flows.** *Cash Flows from Operating Activities*.

Net cash provided by operating activities of continuing operations decreased from $51.8 million in 2001 to $50.6 million in 2002 and then increased to $56.7 million in 2003. In 2003, income from continuing operations before gain on sale of investment properties increased $2.4 million. Additionally, depreciation and amortization increased $3.2 million, primarily due to write-offs of unamortized tenant improvements and leasing costs related to certain tenants who effected early terminations of their lease obligations. Further contributing to the increase in net cash provided by operating activities was an increase in residential lot and outparcel cost of sales of approximately $3.4 million due to increased lot sales in 2003. Partially offsetting the increase in net cash provided by operating activities were decreases of approximately $3.0 million in changes in other operating assets and liabilities.

In 2002, the decrease in net cash provided by operating activities of continuing operations was primarily due to a decrease in income from continuing operations before gain on sale of investment properties of approximately $15.5 million. This decrease was partially offset by an increase in depreciation and amortization of approximately $3.6 million due to the aforementioned office buildings and retail center becoming partially operational for financial reporting purposes and to write-offs of unamortized tenant improvements and leasing commissions related to lease terminations in 2002. Changes in other operating assets and liabilities increased approximately $5.1 million and residential lot and outparcel development and acquisition expenditures decreased approximately $2.0 million, also partially offsetting the decrease in net cash provided by operating activities.

*Cash Flows from Discontinued Operations.* Net cash provided by operating activities of discontinued operations increased from $24.7 million in 2001 to $38.7 million and $41.9 million in 2002 and 2003, respectively. Five of the properties included in discontinued operations were sold in 2003, whereas 2002 reflected a full year of activity for these same properties. See Note 8 for detailed information.

*Cash Flows from Investing Activities*. Net cash used in investing activities decreased from $104.0 million in 2001 to $73.0 million in 2002, and then increased to net cash provided by investing activities of $185.8 million in 2003. In 2003, net cash provided by sales activities increased $252.8 million due to the aforementioned sales of investment properties. Also contributing to the increase in net cash provided by investing activities was an increase of $25.6 million in collection of notes receivable, net of investment in, resulting from the repayment of the 650 Massachusetts Avenue note receivable. Distributions in excess of income from unconsolidated joint ventures increased approximately $24.5 million, consisting primarily of an increase in distributions of approximately $22.5 million. The increase in distributions was primarily due to distributions of $26.3 million from Crawford Long CPI, LLC. In May 2003, Crawford Long CPI, LLC, in which the Company is a 50% partner, obtained non-recourse financing of $55 million. The proceeds from this financing were distributed to the partners. Also contributing to the net increase in distributions was an increase of approximately $1.7 million from CSC Associates, partially offset by a decrease in distributions from Wildwood Associates of approximately $4.7 million. The increase in net cash provided by investing

activities was partially offset by an increase of approximately $22.6 million in property acquisition and development expenditures as a result of increased development activity in 2003 compared to 2002. Also partially offsetting the increase in net cash used in investing activities were increases of $24.1 million in investment in unconsolidated joint ventures. Investment in CL Realty, L.L.C. increased approximately $26.2 million, which was primarily utilized to fund the Company s portion of land acquisition costs in connection with CL Realty, L.L.C. s new residential developments. These increases in contributions were partially offset by a decrease in contributions to Crawford Long CPI, LLC of approximately $4.0 million, as development of the Emory Crawford Long Medical Office Tower was substantially completed in February 2002.

The decrease in net cash used in investing activities in 2002 was primarily due to a decrease of approximately $54.2 million in property acquisition and development expenditures, as a result of the Company having a lower level of projects under development in 2002. Investment in unconsolidated joint ventures decreased approximately $34.5 million, which also contributed to the decrease in net cash used in investing activities. This decrease was primarily due to a decrease in contributions of approximately $15.4 million to CPI/FSP I, L.P., as construction of Austin Research Park Buildings III and IV was completed in 2001, a decrease in contributions of approximately $13.0 million to Crawford Long CPI, LLC in 2002, as construction of the Emory Crawford Long Medical Office Tower was substantially completed in February 2002, and a decrease in contributions of approximately $1.1 million to 285 Venture, LLC, as construction of 1155 Perimeter Center

West was completed in 2001. Contributions to Gateway also decreased approximately $7.8 million. The decrease in investment in unconsolidated joint ventures was partially offset by an increase in contributions of approximately $4.0 million to Ten Peachtree Place Associates in 2002. The decrease in net cash paid in acquisition of business of approximately $2.1 million, which resulted from the acquisition of the remaining 25% interest in CPS in the first quarter of 2001, and a decrease in change in other assets, net, of approximately $6.8 million, both further contributed to the decrease in net cash used in investing activities. Net cash provided by sales activities decreased approximately $45.8 million due primarily to the sale of Colonial Plaza MarketCenter in February 2001, which partially offset the decrease in net cash used in investing activities. Collection of notes receivable decreased approximately $2.9 million, which also partially offset the decrease in net cash used in investing activities. Further offsetting the decrease in net cash used in investment activities in 2002 was a decrease in distributions in excess of income from unconsolidated joint ventures of approximately $12.7 million, consisting of a decrease in total distributions of approximately $8.9 million and an increase in income of approximately $3.8 million. The decrease in total distributions was primarily due to a decrease of approximately $17.6 million from Gateway, as a result of refinancing Gateway s construction loan in 2001, partially offset by increases in total distributions of approximately $7.1 million from Wildwood Associates and $1.9 million from CPI/FSP I, L.P.

*Cash Flows from Financing Activities*. Net cash provided by financing activities decreased from $35.5 million in 2001 to net cash used in financing activities of $19.4 million in 2002 and $278.0 million in 2003. The increase in net cash used in financing activities in 2003 was primarily attributable to an increase of $164.5 million in net amounts paid on the credit facility and a decrease of $152.5 million in proceeds from other notes payable, due to the February 2002 refinancing of Bank of America Plaza. Also contributing to the increase in net cash used in financing activities was a $98.9 million increase in common dividends paid, primarily due to a special dividend of $2.07 per common share paid in September 2003. Preferred dividends paid also increased $2.4 million due to the preferred stock offering in July 2003 (see Note 6). An increase of $9.7 million due to a distribution to a minority partner from the 2003 Mira Mesa sale also contributed to the increase in net cash used in financing activities. Partially offsetting the increase in net cash used in financing activities was the receipt of $96.3 million of net proceeds from the aforementioned July 2003 preferred stock offering. A decrease of approximately $34.9 million in common stock repurchases, net of common stock sold, and a decrease of $38.3 in repayment of other notes payable due to the aforementioned refinancing of Bank of America also partially offset the increase in net cash used in financing activities.

The decrease in net cash provided by financing activities in 2002 was primarily attributable to an increase of approximately $67.8 million in repayment of other notes payable due to the refinancing of Bank of America Plaza (see Note 4). Also contributing to the decrease in net cash provided by financing activities to net cash used in financing activities was an increase of $29.4 million of common stock repurchases. An increase in the dividends paid per share to $1.48 in 2002 from $1.39 in 2001 also contributed to the decrease in net cash provided by financing activities as dividends paid increased approximately $4.8 million. Additionally, common stock sold, net of expenses, decreased by approximately $5.1 million. The increase in proceeds from other notes payable of approximately $26.3 million due to the aforementioned refinancing of Bank of America Plaza and an increase of approximately $25.8 million in net amounts drawn on the credit facility partially offset the decrease in net cash provided by financing activities.

**Effects of Inflation.** The Company attempts to minimize the effects of inflation on income from operating properties by using rents tied to tenants sales, periodic fixed-rent increases or increases based on the Consumer Price Index, and/or pass-through of certain operating expenses of properties to tenants.

**Other Matters.** The events of September 11, 2001 adversely affected the pricing and availability of property insurance. In particular, premiums increased and terrorism insurance coverage became harder to obtain. The availability of coverage has improved and, at this time, the Company and its unconsolidated joint ventures are adequately insured on all of their assets. While the Company s cost of property insurance coverage has increased,

management believes the costs are currently reasonable and should not have a material impact on the Company s financial condition or results of operations in 2004. There can be no assurance that this situation will continue beyond 2004.

**Item 7A. Quantitative and Qualitative Disclosure about Market Risk**

The Company is exposed to the impact of interest rate changes as a result of variable rate debt held by the Company. A loan related to the Company s airplane has a variable rate. The Company also has a variable rate credit facility. No amounts were drawn on this facility as of December 31, 2003. The Company does not enter into contracts for trading purposes and does not use leveraged instruments.

The following table summarizes the Company s market risk associated with notes payable and notes receivable as of December 31, 2003. The information presented below should be read in conjunction with Notes 3 and 4. The table presents scheduled principal repayments and related weighted average interest rates by expected year of maturity. Variable rate represents the floating interest rate calculated at December 31, 2003.

| ($ in thousands) | Expected Year of Maturity 2004 | 2005 | 2006 | 2007 | 2008 | Thereafter | Total | Fair Value |
|---|---|---|---|---|---|---|---|---|
| **Notes Payable:** | | | | | | | | |
| Fixed Rate | $ 9,080 | $ 27,915 | $ 17,827 | $ 68,623 | $ 16,069 | $ 357,414 | $ 496,928 | $ 555,734 |
| Average Interest Rate | 7.45% | 7.70% | 7.61% | 8.02% | 7.07% | 7.52% | 7.59% | |
| Variable Rate | $ 1,053 | $ | $ | $ | $ | $ | $ 1,053 | $ 1,053 |
| Average Interest Rate | 3.50% | | | | | | 3.50% | |
| **Notes Receivable:** | | | | | | | | |
| Fixed Rate | $ 2,045 | $ 1 | $ 1 | $ 1 | $ 1 | $ 1 | $ 2,050 | $ 2,050 |
| Average Interest Rate | 3.00% | 8.50% | 8.50% | 8.50% | 8.50% | 8.50% | 3.02% | |

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## Item 8. Financial Statements and Supplementary Data

The Consolidated Financial Statements and Notes to Consolidated Financial Statements of the Registrant and Report of Independent Registered Public Accounting Firm are included in a separate section of this report.

Selected quarterly information (unaudited) for the two years ended December 31, 2003 ($ in thousands, except per share amounts):

| | Quarters | | | |
|---|---|---|---|---|
| | First | Second | Third | Fourth |
| 2003: | | | | |
| Revenues | $ 62,881 | $ 41,149 | $ 41,273 | $ 44,300 |
| Income from unconsolidated joint ventures | 6,497 | 7,663 | 6,932 | 3,527 |
| Gain on sale of investment properties, net of applicable income tax provision | 1,003 | 90,956 | 2,178 | 6,421 |
| Income from continuing operations | 24,456 | 96,788 | 9,557 | 10,423 |
| Discontinued operations | 3,138 | 46,712 | 51,054 | 33 |
| Net income available to common stockholders | 27,594 | 143,500 | 59,190 | 8,519 |
| Basic income from continuing operations per common share | .51 | 2.01 | .17 | .18 |
| Basic net income per common share | .57 | 2.97 | 1.22 | .18 |
| Diluted income from continuing operations per common share | .51 | 1.97 | .16 | .17 |
| Diluted net income per common share | .57 | 2.92 | 1.19 | .17 |
| 2002: | | | | |
| Revenues | $ 42,194 | $ 41,522 | $ 45,029 | $ 42,402 |
| Income from unconsolidated joint ventures | 7,030 | 6,601 | 6,880 | 6,159 |
| Gain on sale of investment properties, net of applicable income tax provision | 1,029 | 1,042 | 1,028 | 3,155 |
| Income from continuing operations | 6,485 | 9,651 | 9,014 | 9,720 |
| Discontinued operations | 2,789 | 3,061 | 2,996 | 4,156 |
| Net income available to common stockholders | 9,274 | 12,712 | 12,010 | 13,876 |
| Basic income from continuing operations per common share | .13 | .20 | .18 | .20 |
| Basic net income per common share | .19 | .26 | .24 | .29 |
| Diluted income from continuing operations per common share | .13 | .19 | .18 | .20 |
| Diluted net income per common share | .18 | .25 | .24 | .28 |

Note: The above per share quarterly information may not sum to full year per share numbers due to rounding.

Other financial statements and financial statement schedules required under Regulation S-X are filed pursuant to Item 15 of Part IV of this report.

## Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

Not applicable.

## Item 9A.Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specific in the SEC s rules and forms, and that such information is accumulated and communicated to the management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. Management necessarily applied its judgment in assessing the costs and benefits of such controls and procedures, which, by their nature, can provide only reasonable assurance regarding management s control objectives. We also have investments in certain unconsolidated entities. As we do not always control or manage these entities, our disclosure controls and procedures with respect to such entities are necessarily more limited than those we maintain with respect to our consolidated subsidiaries.

The Company s management, including the Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls can prevent all errors and all fraud. A control system, no

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matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. There are inherent limitations in all control systems, including the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of one or more persons. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and, while our disclosure controls and procedures are designed to be effective under circumstances where they should reasonably be expected to operate effectively, there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Because of the inherent limitations in any control system, misstatements due to error or fraud may occur and not be detected.

As of the end of the period covered by this annual report, the Company, under the supervision of the Chief Executive Officer and Chief Financial Officer and with the participation of the Company s management, carried out an evaluation of the effectiveness of the design and operation of the Company s disclosure controls and procedures pursuant to the rules and regulations of the Exchange Act. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company s disclosure controls and procedures were effective, in all material respects, in timely alerting them to material information relating to the Company required to be included in the Company s periodic SEC filings. No changes were made in the Company s internal controls over financial reporting that occurred during the last fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company s internal controls over financial reporting.

Subsequent to the original evaluation of internal control, the Company restated its consolidated statements of cash flows as described in the Explanatory Note in the forepart of this Form 10-K/A and in Note 10 to the consolidated financial statements. Management has made changes to its internal controls consistent with the requirements of Section 404 of the Sarbanes-Oxley Act of 2002 that should improve controls over the preparation of the statement of cash flows. After considering the effect of the restatement, management continues to believe that the Company s disclosure controls and procedures were effective as of the end of the period covered by this annual report.

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## PART III

### Item 10. Directors and Executive Officers of the Registrant

The information required by Items 401 and 405 of Regulation S-K is presented in Item X in Part I above and is included under the captions Election of Directors and Section 16(A) Beneficial Ownership Reporting Compliance in the Proxy Statement relating to the 2004 Annual Meeting of the Registrant s Stockholders, and is incorporated herein by reference. The Company adopted a Code of Business Conduct and Ethics (the Code ) applicable to its Board of Directors and all of its employees. The Code is publicly available on the Investor Relations page of its Web site at www.cousinsproperties.com. Section 1 of the Code applies to the Company s senior executive and financial officers and is a code of ethics as defined by applicable SEC rules and regulations. If the Company makes any amendments to the Code other than technical, administrative, or other non-substantive amendments, or grants any waivers, including implicit waivers, from a provision of the Code to the Company s senior executive or financial officers, the Company will disclose on its Web site the nature of the amendment or waiver, its effective date and to whom it applies.

### Item 11. Executive Compensation

The information under the captions Executive Compensation (other than the Committee Report on Compensation) and Compensation of Directors in the Proxy Statement relating to the 2004 Annual Meeting of the Registrant s Stockholders is incorporated herein by reference.

### Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information under the captions Beneficial Ownership of Common Stock and Equity Compensation Plan Information in the Proxy Statement relating to the 2004 Annual Meeting of the Registrant s Stockholders is incorporated herein by reference.

### Item 13. Certain Relationships and Related Transactions

The information under the caption Certain Transactions in the Proxy Statement relating to the 2004 Annual Meeting of the Registrant s Stockholders is incorporated herein by reference.

### Item 14. Principal Accountant Fees and Services

The information under the caption Summary of Fees to Independent Public Accountants for Fiscal 2003 and 2002 in the Proxy Statement relating to the 2004 Annual Meeting of the Registrant s Stockholders is incorporated herein by reference.

## PART IV

### Item 15. Exhibits, Financial Statement Schedules, and Reports on Form 8-K

(a) 1. Financial Statements

A. The following Consolidated Financial Statements of the Registrant, together with the applicable Report of Independent Registered Public Accounting Firm, are included in this report on the pages indicated.


| | Page Number |
|---|---|
| Report of Independent Registered Public Accounting Firm | F-1 |
| Consolidated Balance Sheets - December 31, 2003 and 2002 | F-2 |
| Consolidated Statements of Income for the Years Ended December 31, 2003, 2002 and 2001 | F-3 |
| Consolidated Statements of Stockholders Investment for the Years Ended December 31, 2003, 2002 and 2001 | F-4 |
| Consolidated Statements of Cash Flows (As restated) for the Years Ended December 31, 2003, 2002 and 2001 | F-5 |
| Notes to Consolidated Financial Statements | F-6 |


B. The following Financial Statements, together with the applicable Report of Independent Registered Public Accounting Firm, of CSC Associates, L.P., a joint venture of the Registrant meeting the criteria for a significant subsidiary under the rules and regulations of the Securities and Exchange Commission, are included in this report on the pages indicated.


| | Page Number |
|---|---|
| Report of Independent Registered Public Accounting Firm | S-1 |
| Balance Sheets - December 31, 2003 and 2002 | S-2 |
| Statements of Income for the Years Ended December 31, 2003, 2002 and 2001 | S-3 |
| Statements of Partners Capital for the Years Ended December 31, 2003, 2002 and 2001 | S-4 |
| Statements of Cash Flows for the Years Ended December 31, 2003, 2002 and 2001 | S-5 |
| Notes to Financial Statements | S-6 |

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**Item 15. Continued**

2. Financial Statement Schedules

The following financial statement schedules are included in this report on the pages indicated.

| | | Page Number |
|---|---|---|
| A. | Cousins Properties Incorporated and Consolidated Entities:<br>Schedule III- Real Estate and Accumulated Depreciation - December 31, 2003 | F-28 through F-33 |
| B. | CSC Associates, L.P.:<br>Schedule III- Real Estate and Accumulated Depreciation - December 31, 2003 | S-11 |

NOTE: Other schedules are omitted because of the absence of conditions under which they are required or because the required information is given in the financial statements or notes thereto.

3. Exhibits

| | |
|---|---|
| 3(a)(i) | Restated and Amended Articles of Incorporation of Registrant, as amended August 9, 1999, filed as Exhibit 3.1 in the Registrant s Form 10-Q for the quarter ended June 30, 2002, and incorporated herein by reference. |
| 3(b) | By-laws of Registrant, as amended April 29, 1993, filed as Exhibit 3.2 in the Registrant s Form 10-Q for the quarter ended June 30, 2002, and incorporated herein by reference. |
| 4(a) | Dividend Reinvestment Plan as restated as of March 27, 1995, filed in the Registrant s Form S-3 dated March 27, 1995, and incorporated herein by reference. |
| 10(a)(i) | Cousins Properties Incorporated 1989 Stock Option Plan, as renamed the 1995 Stock Incentive Plan and approved by the Stockholders on May 6, 1996, filed as Exhibit A to the Registrant s Proxy Statement dated May 6, 1996, as amended, filed in the Registrant s Proxy Statement dated March 27, 1998 and incorporated herein by reference. |
| 10(a)(ii) | Cousins Properties Incorporated 1999 Incentive Stock Plan, as amended and restated, approved by the Stockholders on May 6, 2003, filed as Annex A to the Registrant s Proxy Statement dated March 25, 2003, and incorporated herein by reference. |
| 10(b)(i) | Cousins Properties Incorporated Profit Sharing Plan, as amended and restated effective as of January 1, 2002, filed as Exhibit 10(b)(i) to the Registrant s Form 10-K for the year ended December 31, 2002 and incorporated herein by reference. |
| 10(b)(ii) | Cousins Properties Incorporated Profit Sharing Trust Agreement as effective as of January 1, 1991, filed as Exhibit 10(b)(ii) to the Registrant s Form 10-K for the year ended December 31, |

2002 and incorporated herein by reference.

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**Item 15. Continued**

| | |
|---|---|
| 10(d) | Cousins Properties Incorporated Stock Plan for Outside Directors, as approved by the Stockholders on April 29, 1997, filed as Exhibit 10(d) to the Registrant s Form 10-K for the year ended December 31, 2002 and incorporated herein by reference. |
| 10(e) | Cousins Properties Incorporated Credit Agreement as of August 31, 2001 among Cousins Properties Incorporated, the Banks named therein, Bank of America, N.A., as Administrative Agent, Wachovia Bank, N.A., as Syndication Agent and each of Bank of America Securities LLC and Wachovia Securities, Inc., as Joint Lead Arrangers and Joint Book Managers, filed as Exhibit 10(e) to the Registrant s Form 10-K for the year ended December 31, 2001, and incorporated herein by reference. |
| 11 | Computation of Per Share Earnings. Data required by SFAS No. 128, Earnings Per Share, is provided in Note 1 of the Consolidated Financial Statements of Registrant. |
| 21* | Subsidiaries of the Registrant. |
| 23* | Consent of Registered Independent Public Accounting Firm. |
| 31.1* | Certification of the Chief Executive Officer Pursuant to Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2* | Certification of the Chief Financial Officer Pursuant to Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1* | Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2* | Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

(b) Reports on Form 8-K.

The Company filed a Current Report on Form 8-K dated October 27, 2003, pursuant to Item 12 of Form 8-K, Results of Operations and Financial Condition, for the quarter ended September 30, 2003. The Company filed a Current Report on Form 8-K dated December 10, 2003, pursuant to Item 5 of Form 8-K, Other Events and Required FD Disclosure, related to the Company s risk factors. There were no other reports filed on Form 8-K in the quarter ended December 31, 2003.

*Filed herewith.

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## SIGNATURES

Pursuant to the requirements of Section 13 or 15 (d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Cousins Properties Incorporated
(Registrant)

Dated: March 23, 2005

BY: /s/ James A. Fleming

James A. Fleming
Executive Vice President and Chief Financial Officer
(Duly Authorized Officer and Principal Financial and Accounting Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the date indicated.

| Signature | Capacity | Date |
|---|---|---|
| **Principal Executive Officer:** | | |
| /s/ Thomas D. Bell, Jr.<br>Thomas D. Bell, Jr. | President, Chief Executive Officer and Vice Chairman of the Board | March 23, 2005 |
| **Principal Financial and Accounting Officer:** | | |
| /s/ James A. Fleming<br>James A. Fleming | Executive Vice President and Chief Financial Officer | March 23, 2005 |
| **Additional Directors:** | | |
| /s/ T. G. Cousins<br>T. G. Cousins | Chairman of the Board | March 23, 2005 |
| /s/ Erskine B. Bowles<br>Erskine B. Bowles | Director | March 23, 2005 |
| /s/ Richard W. Courts, II | Director | March 23, 2005 |

| | | |
|---|---|---|
| Richard W. Courts, II | | |
| /s/ Lillian C. Giornelli | Director | March 23, 2005 |
| Lillian C. Giornelli | | |
| /s/ Taylor Glover | Director | March 23, 2005 |
| Taylor Glover | | |
| /s/ James Hance | Director | March 23, 2005 |
| James Hance | | |
| /s/ Boone A. Knox | Director | March 23, 2005 |
| Boone A. Knox | | |
| /s/ John J. Mack | Director | March 23, 2005 |
| John J. Mack | | |

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| Signature | Capacity | Date |
|---|---|---|
| /s/ Hugh L. McColl, Jr.<br>Hugh L. McColl, Jr. | Director | March 23, 2005 |
| /s/ William Porter Payne<br>William Porter Payne | Director | March 23, 2005 |

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## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

**To Cousins Properties Incorporated:**

We have audited the accompanying consolidated balance sheets of Cousins Properties Incorporated (a Georgia corporation) and consolidated entities (the Company ) as of December 31, 2003 and 2002, and the related consolidated statements of income, stockholders investment and cash flows for each of the three years in the period ended December 31, 2003. Our audits also included the financial statement schedule in the index at Item 15. These consolidated financial statements and financial statement schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Cousins Properties Incorporated and consolidated entities as of December 31, 2003 and 2002 and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2003 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, such financial statement schedule, when considered in relation to the basic financial statements taken as a whole, present fairly, in all material respects, the information set forth therein.

As discussed in Note 8 to the financial statements, the Company changed its method of accounting for discontinued operations in 2002 to conform to Statement of Financial Accounting Standards No. 144.

As discussed in Note 10 to the consolidated financial statements, the Company restated its consolidated statements of cash flows for each of the three years in the period ended December 31, 2003.

DELOITTE & TOUCHE LLP

Atlanta, Georgia

February 25, 2004, except for Notes 4, 8 and 12 as to which the date is November 8, 2004 and except for Note 10 as to which the date is March 23, 2005

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**Cousins Properties Incorporated and Consolidated Entities**
**CONSOLIDATED BALANCE SHEETS**

**($ in thousands, except share and per share amounts)**

| | December 31, | |
|---|---|---|
| | 2003 | 2002 |
| ASSETS | | |
| **PROPERTIES:** | | |
| Operating properties, net of accumulated depreciation of $162,955 in 2003 and $155,100 in 2002 | **$ 686,788** | $ 757,329 |
| Land held for investment or future development | **17,435** | 16,632 |
| Projects under construction | **152,042** | 171,135 |
| Residential lots under development | **22,496** | 20,100 |
| Total Properties | **878,761** | 965,196 |
| **CASH AND CASH EQUIVALENTS,** at cost, which approximates market | **13,061** | 6,655 |
| **RESTRICTED CASH** | **3,661** | 2,816 |
| **NOTES AND OTHER RECEIVABLES** | **19,847** | 50,607 |
| **INVESTMENT IN UNCONSOLIDATED JOINT VENTURES** | **185,221** | 185,516 |
| **OTHER ASSETS,** including goodwill of $15,696 in 2003 and $15,612 in 2002 | **39,863** | 37,287 |
| **TOTAL ASSETS** | **$ 1,140,414** | $ 1,248,077 |
| LIABILITIES AND STOCKHOLDERS INVESTMENT | | |
| **NOTES PAYABLE** | **$ 497,981** | $ 669,792 |
| **ACCOUNTS PAYABLE AND ACCRUED LIABILITIES** | **29,909** | 35,445 |
| **DEPOSITS AND DEFERRED INCOME** | **5,341** | 3,429 |
| **TOTAL LIABILITIES** | **533,231** | 708,666 |
| **MINORITY INTERESTS** | **19,346** | 26,959 |
| **DEFERRED GAIN** | **9,060** | 103,568 |
| **COMMITMENTS AND CONTINGENT LIABILITIES** (Note 4) | | |
| **STOCKHOLDERS INVESTMENT:** | | |
| | **100,000** | |

| | | |
|---|---|---|
| 7.75% Series A cumulative redeemable preferred stock, $1 par value, | | |
| $25 liquidation value; 20,000,000 shares authorized, 4,000,000 and 0 shares issued | | |
| Common stock, $1 par value; 150,000,000 shares authorized, 51,526,647 | | |
| and 50,843,835 shares issued | **51,527** | 50,844 |
| Additional paid-in capital | **298,542** | 288,172 |
| Treasury stock at cost, 2,691,582 and 2,457,482 shares | **(64,894)** | (59,356) |
| Unearned compensation | **(5,803)** | (2,647) |
| Cumulative undistributed net income | **199,405** | 131,871 |
| **TOTAL STOCKHOLDERS INVESTMENT** | **578,777** | 408,884 |
| **TOTAL LIABILITIES AND STOCKHOLDERS INVESTMENT** | **$ 1,140,414** | $ 1,248,077 |

*See notes to consolidated financial statements.*

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**Cousins Properties Incorporated and Consolidated Entities**
**CONSOLIDATED STATEMENTS OF INCOME**

**($ in thousands, except per share amounts)**

| | Years Ended December 31, | | |
|---|---|---|---|
| | **2003** | **2002** | **2001** |
| **REVENUES:** | | | |
| Rental property revenues | **$ 101,389** | $ 97,290 | $ 94,281 |
| Development income | **2,870** | 4,625 | 6,179 |
| Management fees | **8,519** | 9,313 | 7,966 |
| Leasing and other fees | **6,991** | 4,297 | 5,344 |
| Residential lot and outparcel sales | **12,945** | 9,126 | 6,682 |
| Interest and other | **3,940** | 4,393 | 6,061 |
| | **136,654** | 129,044 | 126,513 |
| **COSTS AND EXPENSES:** | | | |
| Rental property operating expenses | **32,674** | 30,613 | 30,505 |
| General and administrative expenses | **29,606** | 27,699 | 26,734 |
| Depreciation and amortization | **39,477** | 36,302 | 32,790 |
| Residential lot and outparcel cost of sales | **10,022** | 7,309 | 5,910 |
| Interest expense | **22,576** | 27,041 | 17,852 |
| Loss on debt extinguishment | | 3,501 | |
| Property taxes on undeveloped land | **768** | 675 | 619 |
| Other | **3,290** | 3,147 | 2,261 |
| | **138,413** | 136,287 | 116,671 |
| **(LOSS) INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES AND INCOME FROM UNCONSOLIDATED JOINT VENTURES** | **(1,759)** | (7,243) | 9,842 |
| **(PROVISION) BENEFIT FOR INCOME TAXES FROM OPERATIONS** | **(2,596)** | (1,526) | 691 |
| **INCOME FROM UNCONSOLIDATED JOINT VENTURES** | **24,619** | 26,670 | 22,897 |
| **INCOME FROM CONTINUING OPERATIONS BEFORE GAIN ON SALE OF INVESTMENT PROPERTIES** | **20,264** | 17,901 | 33,430 |
| **GAIN ON SALE OF INVESTMENT PROPERTIES, NET OF APPLICABLE INCOME TAX PROVISION** | **100,558** | 6,254 | 23,496 |
| **INCOME FROM CONTINUING OPERATIONS** | **120,822** | 24,155 | 56,926 |
| **DISCONTINUED OPERATIONS, NET OF APPLICABLE INCOME TAX PROVISION:** | | | |
| Income from discontinued operations | **27,880** | 22,543 | 13,889 |
| Gain on sale of investment properties, net of minority interest | **93,459** | 1,174 | |

| | | | |
|---|---|---|---|
| | **121,339** | 23,717 | 13,889 |
| **NET INCOME** | **242,161** | 47,872 | 70,815 |
| **PREFERRED DIVIDENDS** | **3,358** | | |
| **NET INCOME AVAILABLE TO COMMON STOCKHOLDERS** | **$ 238,803** | $ 47,872 | $ 70,815 |
| **BASIC NET INCOME PER COMMON SHARE:** | | | |
| Income from continuing operations | **$ 2.43** | $ .49 | $ 1.16 |
| Discontinued operations | **2.51** | .48 | .28 |
| Basic net income available to common stockholders | **$ 4.94** | $ .97 | $ 1.44 |
| **DILUTED NET INCOME PER COMMON SHARE:** | | | |
| Income from continuing operations | **$ 2.38** | $ .48 | $ 1.13 |
| Discontinued operations | **2.45** | .48 | .28 |
| Diluted net income available to common stockholders | **$ 4.83** | $ .96 | $ 1.41 |
| **CASH DIVIDENDS DECLARED PER COMMON SHARE** | **$ 3.55** | $ 1.48 | $ 1.39 |
| **WEIGHTED AVERAGE SHARES** | **48,313** | 49,252 | 49,205 |
| **DILUTED WEIGHTED AVERAGE SHARES** | **49,415** | 49,937 | 50,280 |

*See notes to consolidated financial statements.*

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**Cousins Properties Incorporated and Consolidated Entities**
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS INVESTMENT**

**Years Ended December 31, 2003, 2002 and 2001**
**($ in thousands, except share amounts)**

| | Preferred Stock | Common Stock | Additional Paid-In Capital | Treasury Stock | Unearned Compensation | Cumulative Undistributed Net Income | Total |
|---|---|---|---|---|---|---|---|
| **BALANCE, December 31, 2000** | $ | $ 49,364 | $ 259,659 | $ (4,990) | $ (4,690) | $ 155,124 | $ 454,467 |
| Net income, 2001 | | | | | | 70,815 | 70,815 |
| Common stock issued pursuant to: | | | | | | | |
| Exercise of options and director stock plan | | 162 | 2,374 | | | | 2,536 |
| Dividend reinvestment plan | | 578 | 13,299 | | | | 13,877 |
| Stock grant and related amortization, net of forfeitures | | 2 | (93) | | 1,110 | | 1,019 |
| Income tax benefit from stock options | | | 1,029 | | | | 1,029 |
| Common dividends paid | | | | | | (68,595) | (68,595) |
| Purchase of treasury stock | | | | (12,475) | | | (12,475) |
| **BALANCE, December 31, 2001** | | 50,106 | 276,268 | (17,465) | (3,580) | 157,344 | 462,673 |
| Net income, 2002 | | | | | | 47,872 | 47,872 |
| Common stock issued pursuant to: | | | | | | | |
| Exercise of options and director stock plan | | 750 | 10,562 | | | | 11,312 |
| Stock grant and related amortization, net of forfeitures | | (12) | (330) | | 933 | | 591 |
| Income tax benefit from stock options | | | 1,672 | | | | 1,672 |
| Common dividends paid | | | | | | (73,345) | (73,345) |
| Purchase of treasury stock | | | | (41,891) | | | (41,891) |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| **BALANCE, December 31, 2002** | | 50,844 | 288,172 | (59,356) | (2,647) | 131,871 | 408,884 |
| Net income, 2003 | | | | | | 242,161 | 242,161 |
| Preferred stock issued pursuant to 4,000,000 share stock offering, net of expenses | 100,000 | | (3,736) | | | | 96,264 |
| Preferred dividends paid | | | | | | (2,389) | (2,389) |
| Common stock issued pursuant to: | | | | | | | |
| Exercise of options and director stock plan | | 558 | 9,292 | | | | 9,850 |
| Stock grant and related amortization, net of forfeitures | | 125 | 3,646 | | (3,156) | | 615 |
| Income tax benefit from stock options | | | 1,168 | | | | 1,168 |
| Common dividends paid | | | | | | (172,238) | (172,238) |
| Purchase of treasury stock | | | | (5,538) | | | (5,538) |
| **BALANCE, December 31, 2003** | **$ 100,000** | **$ 51,527** | **$ 298,542** | **$ (64,894)** | **$ (5,803)** | **$ 199,405** | **$ 578,777** |

*See notes to consolidated financial statements.*

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**Cousins Properties Incorporated and Consolidated Entities**
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

***($ in thousands)***

| | Years Ended December 31, | | |
|---|---|---|---|
| | **2003** | **2002** | **2001** |
| | **(As restated, See Note 10)** | **(As restated, See Note 10)** | **(As restated, See Note 10)** |
| **CASH FLOWS FROM OPERATING ACTIVITIES:** | | | |
| Income from continuing operations before gain on sale of investment properties | **$ 20,264** | $ 17,901 | $ 33,430 |
| Adjustments to reconcile income from continuing operations before gain on sale of investment properties to net cash provided by operating activities: | | | |
| Depreciation and amortization, net of minority interest s share | **39,477** | 36,302 | 32,695 |
| Amortization of unearned compensation | **615** | 591 | 1,019 |
| Stock appreciation right expense (credit) | | 29 | (276) |
| Cash charges to expense accrual for stock appreciation rights | | (347) | (975) |
| Effect of recognizing rental revenues on a straight-line basis | **(851)** | (188) | (1,376) |
| Residential lot and outparcel cost of sales | **9,148** | 5,715 | 4,445 |
| Residential lot and outparcel development and acquisition expenditures | **(11,064)** | (12,000) | (13,964) |
| Income tax benefit from stock options | **1,168** | 1,672 | 1,029 |
| Changes in other operating assets and liabilities: | | | |
| Change in other receivables | **4,265** | (2,642) | 1,990 |
| Change in accounts payable and accrued liabilities | **(6,317)** | 3,562 | (6,188) |
| Net cash provided by operating activities of continuing operations | **56,705** | 50,595 | |

(1) There were no loans 90 days past due and still accruing interest at March 31, 2014.
(2) Net of LIP.

| | Loans Past Due as of December 31, 2013 | | | | | |
|---|---|---|---|---|---|---|
| | 31-60 Days | 61-90 Days | Over 90 Days | Total | Current | Total Loans (1) (2) |
| | (In thousands) | | | | | |
| Real estate: | | | | | | |
| One-to-four family residential: | | | | | | |
| Owner occupied | $923 | $337 | $575 | $1,835 | $156,962 | $158,797 |
| Non-owner occupied | — | — | 692 | 692 | 121,185 | 121,877 |
| Multifamily | — | — | — | — | 117,181 | 117,181 |
| Commercial real estate | 331 | — | 1,089 | 1,420 | 245,982 | 247,402 |
| Construction/land development | — | — | 223 | 223 | 22,904 | 23,127 |
| Total real estate | 1,254 | 337 | 2,579 | 4,170 | 664,214 | 668,384 |
| Business | — | — | — | — | 1,142 | 1,142 |
| Consumer | 103 | 34 | — | 137 | 9,064 | 9,201 |

| Total | $1,357 | $371 | $2,579 | $4,307 | $674,420 | $678,727 |
|---|---|---|---|---|---|---|

(1) There were no loans 90 days past due and still accruing interest at December 31, 2013.
(2) Net of LIP.

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FIRST FINANCIAL NORTHWEST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Credit Quality Indicators. The Company utilizes a nine-point risk rating system and assigns a risk rating for all credit exposures. The risk rating system is designed to define the basic characteristics and identify risk elements of each credit extension. Credits risk rated 1 through 5 are considered to be “pass” credits. Pass credits include assets, such as cash secured loans with funds on deposit with the Bank, where there is virtually no credit risk. Pass credits also include credits that are on the Company's watch list, where the borrower exhibits potential weaknesses, which may, if not checked or corrected, negatively affect the borrower’s financial capacity and threaten their ability to fulfill debt obligations in the future. Credits classified as special mention are risk rated 6 and possess weaknesses that deserve management’s close attention. Special mention assets do not expose the Company to sufficient risk to warrant adverse classification in the substandard, doubtful or loss categories. Substandard credits are risk rated 7. An asset is considered substandard if it is inadequately protected by the current net worth and payment capacity of the borrower or of any collateral pledged. Substandard assets include those characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected. Assets classified as doubtful are risk rated 8 and have all the weaknesses inherent in those credits classified as substandard with the added characteristic that the weaknesses present make collection or liquidation in full highly questionable and improbable, on the basis of currently existing facts, conditions and values. Assets classified as loss are risk rated 9 and are considered uncollectible and cannot be justified as a viable asset for the Company. There were no loans classified as doubtful or loss as of March 31, 2014 and December 31, 2013.

The following tables represent a summary of loans by type and risk category:

| | March 31, 2014 | | | | | | |
|---|---|---|---|---|---|---|---|
| | One-to-Four Family Residential | Multifamily | Commercial Real Estate | Construction/ Land Development | Business | Consumer | Total (1) |
| | (In thousands) | | | | | | |
| Risk Rating: | | | | | | | |
| Pass | $265,112 | $118,998 | $236,888 | $23,065 | $614 | $8,361 | $653,038 |
| Special mention | 5,642 | 1,198 | 14,467 | — | — | — | 21,307 |
| Substandard | 8,490 | 1,443 | 2,065 | — | — | 222 | 12,220 |
| Total | $279,244 | $121,639 | $253,420 | $23,065 | $614 | $8,583 | $686,565 |

(1) Net of LIP.

| | December 31, 2013 | | | | | | |
|---|---|---|---|---|---|---|---|
| | One-to-Four Family Residential | Multifamily | Commercial Real Estate | Construction / Land Development | Business | Consumer | Total (1) |
| | (In thousands) | | | | | | |
| Risk Rating: | | | | | | | |
| Pass | $265,511 | $114,525 | $229,149 | $22,904 | $1,142 | $8,934 | $642,165 |
| Special mention | 5,825 | 1,203 | 15,134 | — | — | 1 | 22,163 |
| Substandard | 9,338 | 1,453 | 3,119 | 223 | — | 266 | 14,399 |
| Total | $280,674 | $117,181 | $247,402 | $23,127 | $1,142 | $9,201 | $678,727 |

(1) Net of LIP.

FIRST FINANCIAL NORTHWEST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

The following tables summarize the loan portfolio by type and payment activity:

| | March 31, 2014 | | | | | | |
|---|---|---|---|---|---|---|---|
| | One-to-Four Family Residential | Multifamily | Commercial Real Estate | Construction / Land Development | Business | Consumer | Total [1] |
| | (In thousands) | | | | | | |
| Performing [2] | $277,644 | $121,411 | $252,714 | $23,065 | $614 | $8,583 | $684,031 |
| Nonperforming [3] | 1,600 | 228 | 706 | — | — | — | 2,534 |
| Total | $279,244 | $121,639 | $253,420 | $23,065 | $614 | $8,583 | $686,565 |

[1] Net of LIP.
[2] There were $158.1 million of owner-occupied one-to-four family residential loans and $119.5 million of non-owner occupied one-to-four family residential loans classified as performing.
[3] There were $1.0 million of owner-occupied one-to-four family residential loans and $600,000 of non-owner occupied one-to-four family residential loans classified as nonperforming.

| | December 31, 2013 | | | | | | |
|---|---|---|---|---|---|---|---|
| | One-to-Four Family Residential | Multifamily | Commercial Real Estate | Construction/ Land Development | Business | Consumer | Total [1] |
| | (In thousands) | | | | | | |
| Performing [2] | $278,377 | $116,948 | $246,204 | $22,904 | $1,142 | $9,157 | $674,732 |
| Nonperforming [3] | 2,297 | 233 | 1,198 | 223 | — | 44 | 3,995 |
| Total | $280,674 | $117,181 | $247,402 | $23,127 | $1,142 | $9,201 | $678,727 |

[1] Net of LIP.
[2] There were $157.3 million of owner-occupied one-to-four family residential loans and $121.1 million of non-owner occupied one-to-four family residential loans classified as performing.
[3] There were $1.5 million of owner-occupied one-to-four family residential loans and $817,000 of non-owner occupied one-to-four family residential loans classified as nonperforming.

The following table presents TDRs and their recorded investment prior to the modification and after the modification:

| | Three Months Ended March 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2014 | | | 2013 | | |
| | Number of Loans | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment | Number of Loans | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment |
| | (Dollars in thousands) | | | | | |
| TDRs that Occurred During the Period: | | | | | | |
| One-to-four family residential: | | | | | | |
| Principal and interest with interest rate concession | 1 | 221 | 221 | — | — | — |
| Commercial real estate: | | | | | | |

| | | | | | | |
|---|---|---|---|---|---|---|
| Principal and interest reamortized with no interest rate concession | — | $ — | $ — | 1 | 335 | 334 |
| Total | 1 | $ 221 | $ 221 | 1 | $ 335 | $ 334 |

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FIRST FINANCIAL NORTHWEST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

At March 31, 2014 and 2013, the Company had no commitments to extend additional credit to borrowers whose loan terms have been modified in TDRs. All TDRs are also classified as impaired loans and are included in the loans individually evaluated for impairment in the calculation of the ALLL.

The TDR that occurred during the quarter ended March 31, 2014 was primarily a result of granting the borrower an interest rate concession for a period of 3.25 years. The impaired portion of the loan with an interest rate concession for a specific period of time is calculated based on the present value of expected future cash flows discounted at the loan's effective interest rate. The effective interest rate is the rate of return implicit on the original loan. This impaired amount increases the ALLL as a valuation allowance is established. As loan payments are received in future periods, the ALLL entry is reversed and the valuation allowance is reduced utilizing the level yield method over the modification period. TDRs resulted in no charge-offs to the ALLL for the three months ended March 31, 2014. TDRs resulted in charge-offs to the ALLL of $4,000 for the three months ended March 31, 2013.

The following is a summary of loans that were modified as TDRs within the previous 12 months and for which there was a payment default during the three months ended March 31, 2014 and 2013:

| | Three Months Ended March 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2014 | | | 2013 | | |
| | Types of Modifications | | | Types of Modifications | | |
| | Number of Loans | No Interest Rate Concession with Modified Principal and Interest Payment | Advancement of Maturity Date | Number of Loans | Interest Only Payments | Interest Rate Concession |
| | (Dollars in thousands) | | | | | |
| TDRs that Subsequently Defaulted: | | | | | | |
| One-to-four family residential | — | $— | $— | 1 | $— | $71 |
| Commercial real estate | 1 | — | 430 | 2 | 2,324 | — |
| Total | 1 | $— | $430 | 3 | $2,324 | $71 |

TDRs that default after they have been modified are typically evaluated individually on a collateral basis. Any additional impairment further reduces the ALLL.

Note 6 - Other Real Estate Owned

The following table is a summary of OREO:

| | Three Months Ended March 31, | |
|---|---|---|
| | 2014 | 2013 |
| | (In thousands) | |
| Balance at beginning of period | $11,465 | $17,347 |
| Loans transferred to OREO | 1,191 | 3,376 |
| Capitalized improvements | — | 33 |

| | | |
|---|---|---|
| Dispositions of OREO | (851 ) | (4,301 ) |
| Market value adjustments | (196 ) | (145 ) |
| Balance at end of period | $11,609 | $16,310 |

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FIRST FINANCIAL NORTHWEST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

OREO includes properties acquired by the Company through foreclosure and deed in lieu of foreclosure. OREO at March 31, 2014 consisted of $1.2 million in one-to-four family residential homes, $9.8 million in commercial real estate properties and $556,000 in construction/land development projects.

Note 7 - Fair Value

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

The Company determines the fair values of its financial instruments based on the fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair values. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect its estimate for market assumptions.

Valuation inputs refer to the assumptions market participants would use in pricing a given asset or liability using one of the three valuation techniques. Inputs can be observable or unobservable. Observable inputs are those assumptions that market participants would use in pricing the particular asset or liability. These inputs are based on market data and are obtained from an independent source. Unobservable inputs are assumptions based on the Company's own information or estimate of assumptions used by market participants in pricing the asset or liability. Unobservable inputs are based on the best and most current information available on the measurement date.

All inputs, whether observable or unobservable, are ranked in accordance with a prescribed 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 whose inputs are observable.
- Level 3 - Instruments whose significant value drivers are unobservable.

The tables below present the balances of assets and liabilities measured at fair value on a recurring basis (there were no transfers between Level 1, Level 2 and Level 3 recurring measurements):

| | Fair Value Measurements at March 31, 2014 | | | |
|---|---|---|---|---|
| | Fair Value Measurements | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| | (In thousands) | | | |
| Available-for-sale investments: | | | | |
| Mortgage-backed investments: | | | | |
| Fannie Mae | $44,629 | $— | $44,629 | $— |
| Freddie Mac | 24,881 | — | 24,881 | — |
| Ginnie Mae | 32,264 | — | 32,264 | — |
| Municipal bonds | 1,933 | — | 1,933 | — |
| U.S. Government agencies | 22,196 | — | 22,196 | — |
| Corporate bonds | 13,965 | — | 13,965 | — |

| $139,868 | $— | $139,868 | $— |
|---|---|---|---|

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FIRST FINANCIAL NORTHWEST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

| | Fair Value Measurements at December 31, 2013 | | | |
|---|---|---|---|---|
| | Fair Value Measurements | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| | (In thousands) | | | |
| Available-for-sale investments: | | | | |
| Mortgage-backed investments: | | | | |
| Fannie Mae | $46,232 | $— | $46,232 | $— |
| Freddie Mac | 25,856 | — | 25,856 | — |
| Ginnie Mae | 33,873 | — | 33,873 | — |
| Municipal bonds | 1,850 | — | 1,850 | — |
| U.S. Government agencies | 22,704 | — | 22,704 | — |
| Corporate bonds | 13,849 | — | 13,849 | — |
| | $144,364 | $— | $144,364 | $— |

The estimated fair value of Level 2 investments is based on quoted prices for similar investments in active markets, identical or similar investments in markets that are not active and model-derived valuations whose inputs are observable.

FIRST FINANCIAL NORTHWEST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

The tables below present the balances of assets and liabilities measured at fair value on a nonrecurring basis.

| | Fair Value Measurements at March 31, 2014 | | | | |
|---|---|---|---|---|---|
| | Fair Value Measurements | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total Losses |
| | (In thousands) | | | | |
| Impaired loans (included in loans receivable, net) [1] | $60,441 | $— | $— | $60,441 | $2,165 |
| OREO [2] | 11,609 | — | — | 11,609 | 196 |
| Total | $72,050 | $— | $— | $72,050 | $2,361 |

[1] The loss represents the specific reserve against loans that were considered impaired at March 31, 2014.
[2] The loss represents OREO market value adjustments for the quarter ended March 31, 2014.

| | Fair Value Measurements at December 31, 2013 | | | | |
|---|---|---|---|---|---|
| | Fair Value Measurements | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total Losses |
| | (In thousands) | | | | |
| Impaired loans (included in loans receivable, net) [1] | $61,985 | $— | $— | $61,985 | $2,180 |
| OREO [2] | 11,465 | — | — | 11,465 | 403 |
| Total | $73,450 | $— | $— | $73,450 | $2,583 |

[1] The loss represents the specific reserve against loans that were considered impaired at December 31, 2013.
[2] The loss represents OREO market value adjustments for the year ended December 31, 2013.

The fair value of impaired loans is calculated using the collateral value method or on a discounted cash flow basis. Inputs used in the collateral value method include appraised values, estimates of certain completion costs and closing and selling costs. Some of these inputs may not be observable in the marketplace. Appraised values may be discounted based on management's historical knowledge, changes in market conditions from the time of valuation and/or management's expertise and knowledge of the borrower.

OREO properties are measured at the lower of their carrying amount or fair value, less costs to sell. Fair values are generally based on third party appraisals of the property, resulting in a Level 3 classification. In cases where the carrying amount exceeds the fair value, less costs to sell, an impairment loss is recognized.

The following table presents quantitative information about Level 3 fair value measurements for financial instruments measured at fair value on a nonrecurring basis.

| | March 31, 2014 | | | |
|---|---|---|---|---|
| | Fair Value | Valuation Technique(s) | Unobservable Input(s) | Range (Weighted Average) |

| | (Dollars in thousands) | | | |
|---|---|---|---|---|
| Impaired Loans | $ 60,441 | Market approach | Adjusted for differences between comparable sales | 0% - 9% (0.44%) |
| OREO | $ 11,609 | Market approach | Adjusted for differences between comparable sales | (16%) - 9.72% (1.85%) |

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FIRST FINANCIAL NORTHWEST, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

The carrying amounts and estimated fair values of financial instruments were as follows:

| | March 31, 2014 | | | | |
|---|---|---|---|---|---|
| | | Estimated | Fair Value Measurements Using: | | |
| | Carrying Value | Fair Value | Level 1 | Level 2 | Level 3 |
| | (In thousands) | | | | |
| Financial Assets: | | | | | |
| Cash on hand and in banks | $5,440 | $5,440 | $5,440 | $— | $— |
| Interest-earning deposits | 28,073 | 28,073 | 28,073 | — | — |
| Investments available-for-sale | 139,868 | 139,868 | — | 139,868 | — |
| Loans receivable, net | 671,848 | 690,026 | — | — | 690,026 |
| FHLB stock | 6,952 | 6,952 | — | 6,952 | — |
| Accrued interest receivable | 3,509 | 3,509 | — | 3,509 | — |
| Financial Liabilities: | | | | | |
| Deposits | 189,083 | 189,083 | 189,083 | — | — |
| Certificates of deposit | 397,964 | 400,301 | — | 400,301 | — |
| Advances from the FHLB | 119,000 | 118,653 | — | 118,653 | — |
| Accrued interest payable | 91 | 91 | — | 91 | — |

| | December 31, 2013 | | | | |
|---|---|---|---|---|---|
| | | Estimated | Fair Value Measurements Using: | | |
| | Carrying Value | Fair Value | Level 1 | Level 2 | Level 3 |
| | (In thousands) | | | | |
| Financial Assets: | | | | | |
| Cash on hand and in banks | $6,074 | $6,074 | $6,074 | $— | $— |
| Interest-earning deposits | 49,501 | 49,501 | 49,501 | — | — |
| Investments available-for-sale | 144,364 | 144,364 | — | 144,364 | — |
| Loans receivable, net | 663,153 | 680,622 | — | — | 680,622 |
| FHLB stock | 7,017 | 7,017 | — | 7,017 | — |
| Accrued interest receivable | 3,698 | 3,698 | — | 3,698 | — |
| Financial Liabilities: | | | | | |
| Deposits | 201,658 | 201,658 | 201,658 | — | — |
| Certificates of deposit | 410,407 | 413,417 | — | 413,417 | — |
| Advances from the FHLB | 119,000 | 118,610 | — | 118,610 | — |
| Accrued interest payable | 88 | 88 | — | 88 | — |

Fair value estimates, methods, and assumptions are set forth below for the Company's financial instruments:

- Financial instruments with book value equal to fair value: The fair value of financial instruments that are short-term or reprice frequently and that have little or no risk are considered to have a fair value equal to book value. These instruments include cash on hand and in banks, interest-bearing deposits, FHLB stock, accrued interest receivable, accrued interest payable and investment transactions payable. FHLB stock is not publicly-traded, however it may be redeemed on a dollar-for-dollar basis, for any amount the Bank is not required to hold, subject to the FHLB’s discretion. The fair value is therefore equal to the book value.

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- Investments available-for-sale: The fair value of all investments excluding FHLB stock was based upon quoted market prices for similar investments in active markets, identical or similar investments in markets that are not active and model-derived valuations whose inputs are observable.

- Loans receivable: For variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. The fair value of fixed-rate loans is estimated using discounted cash flow analysis, utilizing interest rates that would be offered for loans with similar terms to borrowers of similar credit quality. As a result of current market conditions, cash flow estimates have been further discounted to include a credit factor. The fair value of nonperforming loans is estimated using the fair value of the underlying collateral.

- Liabilities: The fair value of deposits with no stated maturity, such as statement savings, NOW and money market accounts, is equal to the amount payable on demand. The fair value of certificates of deposit is based on the discounted value of contractual cash flows using current interest rates for certificates of deposit with similar remaining maturities. The fair value of FHLB advances is estimated based on discounting the future cash flows using current interest rates for debt with similar remaining maturities.

- Off balance sheet commitments: No fair value adjustment is necessary for commitments made to extend credit, which represents commitments for loan originations or for outstanding commitments to purchase loans. These commitments are at variable rates, are for loans with terms of less than one year and have interest rates which approximate prevailing market rates, or are set at the time of loan closing.

Fair value estimates are based on existing balance sheet financial instruments without attempting to estimate the value of anticipated future business. The fair value has not been estimated for assets and liabilities that are not considered financial instruments.

Note 8 - Federal Home Loan Bank Stock

At March 31, 2014, the Bank held $7.0 million of FHLB stock. FHLB stock is carried at par value ($100 per share) and does not have a readily determinable fair value. Ownership of FHLB stock is restricted to the FHLB and member institutions and can only be purchased and redeemed at par.

Management evaluates FHLB stock for impairment. The determination of whether this investment is impaired is based on the Bank's assessment of the ultimate recoverability of cost rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability of cost is influenced by criteria such as: (1) the significance of any decline in net assets of the FHLB as compared to the capital stock amount for the FHLB and the length of time this situation has persisted, (2) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB, (3) the impact of legislative and regulatory changes on institutions and, accordingly, the customer base of the FHLB and (4) the liquidity position of the FHLB.

Prior to 2014, the FHLB announced that the Federal Housing Finance Agency had granted them the authority to repurchase up to $25 million in excess capital stock per quarter and pay quarterly dividends, provided that their financial condition - measured primarily by the ratio of market value of equity-to-par value of capital stock - does not deteriorate. As a result, the FHLB repurchased shares on a pro-rata basis from its shareholders, including 656 shares from the Bank, at par value during the first quarter of 2014. Also, the Bank received $1,767 in dividends from the FHLB in the quarter ended March 31, 2014. During the first quarter of 2013, the Bank received no dividends on

FHLB stock and 659 shares of FHLB stock were repurchased. The Bank has determined there was no OTTI on the FHLB stock investment as of March 31, 2014.

Note 9 - Stock-Based Compensation

In June 2008, First Financial Northwest's shareholders approved the First Financial Northwest, Inc. 2008 Equity Incentive Plan (“Plan”). The Plan provides for the grant of stock options, restricted stock and stock appreciation rights.

Total compensation expense for the Plan was $84,800 and $481,000 for the three months ended March 31, 2014 and 2013, respectively, and the related income tax benefit was $29,700 and $168,000 for the three months ended March 31, 2014 and 2013.

Stock Options

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The Plan authorizes the grant of stock options totaling 2,285,280 shares to Company directors, advisory directors, officers and employees. Option awards are granted with an exercise price equal to the market price of First Financial Northwest's common stock at the grant date. These option awards have a vesting period of five years, with 20% vesting on the anniversary date of each grant date, and a contractual life of 10 years. Any unexercised stock options will expire ten years after the grant date or sooner in the event of the award recipient's death, disability or termination of service with the Company or the Bank. First Financial Northwest has a policy of issuing new shares from authorized but unissued common stock upon the exercise of stock options. At March 31, 2014, remaining options for 766,756 shares of common stock were available for grant under the Plan.

The fair value of each option award is estimated on the grant date using a Black-Scholes model that uses the following assumptions. The dividend yield is based on the current quarterly dividend in effect at the time of the grant. Historical employment data is used to estimate the forfeiture rate. The historical volatility of the Company's stock price over a specified period of time is used for the expected volatility assumption. First Financial Northwest bases the risk-free interest rate on the U.S. Treasury Constant Maturity Indices in effect on the date of the grant. First Financial Northwest elected to use the "Share-Based Payments" method permitted by the Securities and Exchange Commission to calculate the expected term. This method uses the vesting term of an option along with the contractual term, setting the expected life at the midpoint.

A summary of the Company's stock option plan awards for the three months ended March 31, 2014, follows:

| | Shares | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Term in Years | Aggregate Intrinsic Value | Weighted-Average Grant Date Fair Value |
|---|---|---|---|---|---|
| Outstanding at January 1, 2014 | 1,203,535 | $ 9.49 | — | $1,103,186 | $ 2.11 |
| Granted | — | — | — | — | — |
| Exercised | (62,000 ) | 9.78 | — | — | — |
| Forfeited or expired | — | — | — | — | — |
| Outstanding at March 31, 2014 | 1,141,535 | 9.48 | 5.21 | 839,668 | 2.13 |
| Expected to vest assuming a 3% forfeiture rate over the vesting term | 1,135,235 | 9.48 | 5.19 | 831,016 | |
| Exercisable at March 31, 2014 | 931,535 | 9.56 | 4.41 | 551,268 | |

As of March 31, 2014, there was $545,935 of total unrecognized compensation cost related to nonvested stock options granted under the Plan. The cost is expected to be recognized over the remaining weighted-average vesting period of 4.0 years.

Restricted Stock Awards

The Plan authorizes the grant of restricted stock awards amounting to 914,112 shares to directors, advisory directors, officers and employees. Compensation expense is recognized over the vesting period of the awards based on the fair value of the stock at the grant date. The restricted stock awards' fair value is equal to the value on the grant date. Shares awarded as restricted stock vest ratably over a five-year period beginning at the grant date with 20% vesting on the anniversary date of each grant date. At March 31, 2014, remaining restricted stock awards for 74,478 shares were

available to be awarded and are held in trust until they are issued in connection with the agreement. There are 103,400 shares of restricted stock awards previously granted that have not vested as of March 31, 2014.

FIRST FINANCIAL NORTHWEST, INC. AND SUBSIDIARIES
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A summary of changes in nonvested restricted stock awards for the three months ended March 31, 2014, follows:

| Nonvested Shares | Shares | Weighted-Average Grant Date Fair Value |
|---|---|---|
| Nonvested at January 1, 2014 | 103,400 | $8.24 |
| Granted | — | — |
| Vested | — | — |
| Forfeited | — | — |
| Nonvested at March 31, 2014 | 103,400 | 8.24 |
| | | |
| Expected to vest assuming a 3% forfeiture rate over the vesting term | 100,298 | |

As of March 31, 2014, there was $705,890 of total unrecognized compensation costs related to nonvested shares granted as restricted stock awards. The cost is expected to be recognized over the remaining weighted-average vesting period of 3.7 years. There were no shares of restricted stock vested during the quarter ended March 31, 2014 compared to 6,400 shares of restricted stock vested with a fair value of $53,000 during the quarter ended March 31, 2013.

Note 10 - Federal Income Taxes

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. These calculations are based on many complex factors including estimates of the timing of reversals of temporary differences, the interpretation of federal income tax laws, and a determination of the differences between the tax and the financial reporting basis of assets and liabilities. Actual results could differ significantly from the estimates and interpretations used in determining the current and deferred income tax assets and liabilities.

Our primary deferred tax assets relate to our net operating loss carryforward, our ALLL and our employee benefit plans.

Under GAAP, a valuation allowance is required to be recognized if it is “more likely than not” that a portion of the deferred tax asset will not be realized. Our policy is to evaluate our deferred tax assets on a quarterly basis and record a valuation allowance for our deferred tax asset if we do not have sufficient positive evidence indicating that it is more likely than not that some or all of the deferred tax asset will be realized. Each quarter, we considered positive and negative evidence, which includes cumulative losses in the most recent three year period and uncertainty regarding short-term future earnings. We further considered that GAAP places heavy emphasis on prior earnings in determining the realizable deferred tax asset. After reviewing and weighing these various factors, in 2010 we recorded a valuation allowance for the balance of the deferred tax asset in excess of the tax carryback refund potential. During 2013, management determined that a full valuation allowance was no longer appropriate and reversed all but $431,000 of the deferred tax asset valuation allowance as of December 31, 2013. In reaching this determination, management considered the scheduled reversal of deferred tax assets and liabilities, taxes paid in carryback years, available tax planning strategies and projected taxable income.

As of March 31, 2014, the consolidated balance sheet includes gross deferred tax assets of $16.0 million and a deferred tax asset valuation allowance of $431,000 due to a prior period capital loss on investment. Deferred tax liabilities totaled $2.4 million, resulting in a net deferred tax asset of $13.1 million at March 31, 2014.

The Company's federal net operating loss carryforward was $17.7 million at March 31, 2014 and will begin to expire in 2030. The Company had an alternative minimum tax credit carryforward totaling $1.8 million, with no expiration date.

Note 11 - Earnings Per Share

Per the provisions of FASB ASC 260, Earnings Per Share, nonvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents are participating securities and are included in the computation of EPS pursuant to the two-class method. The two-class method is an earnings allocation formula that determines earnings per share for



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FIRST FINANCIAL NORTHWEST, INC. AND SUBSIDIARIES
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each class of common stock and participating security according to dividends declared (or accumulated) and participation rights in undistributed earnings. ESOP shares are considered outstanding for basic and diluted earnings per share when the shares are committed to be released. Certain of the Company's nonvested restricted stock awards qualify as participating securities.

Net income is allocated between the common stock and participating securities pursuant to the two-class method, based on their rights to receive dividends, participate in earnings or absorb losses. Basic earnings per common shares is computed by dividing net earnings allocated to common shareholders by the weighted average number of common shares outstanding during the period, excluding participating nonvested restricted shares.

The following table presents a reconciliation of the components used to compute basic and diluted earnings per share for the periods indicated.

| | Three Months Ended March 31, | |
|---|---|---|
| | 2014 | 2013 |
| | (Dollars in thousands, except share data) | |
| Net income | $2,645 | $1,556 |
| Earnings allocated to participating securities | (16) | (18) |
| Earnings allocated to common shareholders | 2,629 | 1,538 |
| | | |
| Basic weighted-average common shares outstanding | 15,252,445 | 17,380,640 |
| Dilutive stock options | 81,331 | 21,210 |
| Dilutive restricted stock grants | 23,344 | — |
| Diluted weighted-average common shares outstanding | 15,357,120 | 17,401,850 |
| | | |
| Basic earnings per share | $0.17 | $0.09 |
| Diluted earnings per share | $0.17 | $0.09 |

Potential dilutive shares are excluded from the computation of earnings per share if their effect is anti-dilutive. Options to purchase an additional 210,000 and 1,382,524 shares of common stock at March 31, 2014 and 2013, respectively, were not included in the computation of diluted earnings per share because their exercise price resulted in them being antidilutive.

Note 12 - Segment Information

The Company's activities are considered to be a single industry segment for financial reporting purposes. The Company is engaged in the business of attracting deposits from the general public and originating loans for our portfolio in our primary market area. Substantially all income is derived from a diverse base of commercial and residential real estate loans, consumer lending activities and investments.

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

Forward-Looking Statements
Certain matters discussed in this Quarterly Report on Form 10-Q constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements relate to our financial condition, results of operations, plans, objectives, future performance or business. Forward-looking statements are not statements of historical fact, are based on certain assumptions and are generally identified by use of the words “believes,” “expects,”

“anticipates,” “estimates,” “forecasts,” “intends,” “plans,” “targets,” “potentially,” “probably,” “projects,” “outlook” or similar or future or conditional verbs such as “may,” “will,” “should,” “would” and “could.” Forward-looking statements include statements with respect to our beliefs, plans, objectives, goals, expectations, assumptions and statements about, among other things, expectations of the business environment in which we operate, projections of future performance or financial items, perceived opportunities in the market, potential future credit experience, and statements regarding our mission and vision. These forward-looking statements are based upon current management expectations and may, therefore, involve risks and uncertainties. Our actual results, performance, or achievements may differ materially from those suggested, expressed, or implied by forward-looking statements as a result of a wide variety or range of factors including, but not limited to: the credit risks of lending activities, including changes in the level

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and trend of loan delinquencies and write-offs, that may be affected by deterioration in the housing and commercial real estate markets, and may lead to increased losses and nonperforming assets in our loan portfolio, and may result in our allowance for loan losses not being adequate to cover actual losses, and require us to materially increase our reserves; changes in general economic conditions, either nationally or in our market areas; changes in the levels of general interest rates, and the relative differences between short and long term interest rates, deposit interest rates, our net interest margin and funding sources; fluctuations in the demand for loans, the number of unsold homes and other properties and fluctuations in real estate values in our market areas; results of examinations of us by the Federal Reserve Bank of San Francisco and our bank subsidiary by the Federal Deposit Insurance Corporation (“FDIC”), the Washington State Department of Financial Institutions, Division of Banks (“DFI”) or other regulatory authorities, including the possibility that any such regulatory authority may initiate an enforcement action against the Company or the Bank which could require us to increase our reserve for loan losses, write-down assets, change our regulatory capital position, affect our ability to borrow funds or maintain or increase deposits, or impose additional requirements or restrictions on us, any of which could adversely affect our liquidity and earnings; our ability to pay dividends on our common stock; our ability to attract and retain deposits; increases in premiums for deposit insurance; our ability to control operating costs and expenses; the use of estimates in determining the fair value of certain of our assets, which estimates may prove to be incorrect and result in significant declines in valuation; difficulties in reducing risk associated with the loans on our balance sheet; staffing fluctuations in response to product demand or the implementation of corporate strategies that affect our work force and potential associated charges; computer systems on which we depend could fail or experience a security breach; our ability to retain key members of our senior management team; costs and effects of litigation, including settlements and judgments; our ability to implement our branch expansion strategy; our ability to successfully integrate any assets, liabilities, customers, systems, and management personnel we have acquired or may in the future acquire into our operations and our ability to realize related revenue synergies and cost savings within expected time frames and any goodwill charges related thereto; our ability to manage loan delinquency rates; costs and effects of litigation, including settlements and judgments; increased competitive pressures among financial services companies; changes in consumer spending, borrowing and savings habits; legislative or regulatory changes that adversely affect our business including changes in regulatory policies and principles, including the interpretation of regulatory capital or other rules, including as a result of Basel III; the impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd Frank Act") and the implementing regulations; the availability of resources to address changes in laws, rules, or regulations or to respond to regulatory actions; adverse changes in the securities markets; inability of key third-party providers to perform their obligations to us; changes in accounting policies and practices, as may be adopted by the financial institution regulatory agencies or the Financial Accounting Standards Board, including additional guidance and interpretation on accounting issues and details of the implementation of new accounting methods; the economic impact of war or any terrorist activities; other economic, competitive, governmental, regulatory, and technological factors affecting our operations; pricing, products and services; and other risks detailed in our filings with the U.S. Securities and Exchange Commission (“SEC”), including our Annual Report on Form 10-K for the year ended December 31, 2013 ("2013 Form 10-K"). Any of the forward-looking statements that we make in this Form 10-Q and in the other public reports and statements we make may turn out to be wrong because of the inaccurate assumptions we might make, because of the factors illustrated above or because of other factors that we cannot foresee. Because of these and other uncertainties, our actual future results may be materially different from those expressed in any forward-looking statements made by or on our behalf. Therefore, these factors should be considered in evaluating the forward-looking statements, and undue reliance should not be placed on such statements. We undertake no responsibility to update or revise any forward-looking statements.

Overview

First Savings Bank is a wholly-owned subsidiary of First Financial Northwest and, as such, comprises substantially all of the activity for First Financial Northwest. First Savings Bank is a community-based savings bank primarily serving King and to a lesser extent, Pierce, Snohomish and Kitsap counties, Washington through our full-service banking office located in Renton, Washington. First Savings Bank’s business consists of attracting deposits from the public and

utilizing these funds to originate one-to-four family residential, multifamily, commercial real estate, construction/land development, business and consumer loans. Our current business strategy emphasizes one-to-four family residential, multifamily and commercial real estate lending.

Our primary source of revenue is net interest income. Net interest income is the difference between interest income, which is the income that we earn on our loans and investments, and interest expense, which is the interest that we pay on our deposits and borrowings. Changes in levels of interest rates affect our net interest income.

An offset to net interest income is the provision for loan losses, which represents the periodic charge to operations which is required to adequately provide for probable losses inherent in our loan portfolio.

Our noninterest expenses consist primarily of salaries and employee benefits, occupancy and equipment, data processing, OREO-related expenses, professional fees, regulatory assessments and other general and administrative expenses. Salaries and employee benefits consist primarily of the salaries and wages paid to our employees, payroll taxes and expenses for retirement

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and other employee benefits. Occupancy and equipment expenses, which are the fixed and variable costs of buildings and equipment, consist primarily of real estate taxes, depreciation expenses, maintenance and costs of utilities. OREO-related expenses consist primarily of maintenance and costs of utilities for the OREO inventory, market valuation adjustments, build-out expenses, gains and losses from OREO sales, legal fees, real estate taxes and insurance related to the properties included in the OREO inventory.

Net income for the three months ended March 31, 2014 was $2.6 million, or $0.17 per diluted share, as compared to net income of $1.6 million, or $0.09 per diluted share for the three months ended March 31, 2013. The change in operating results in the first quarter of 2014, as compared to the first quarter of 2013, was primarily the result of a $1.4 million decrease in noninterest expense, a $665,000 increase in net interest income, a $500,000 recapture of loan loss provision partially offset by a $1.4 million increase in the federal income tax provision.

During the three months ended March 31, 2014, our total loan portfolio increased $8.7 million, or 1.3% from December 31, 2013, due primarily to a $6.0 million, or 2.4% increase in commercial real estate loans, a $3.5 million, or 2.9% increase in multifamily loans and a $2.1 million, or 6.8% increase in construction/land development loans partially offset by a $1.4 million, or 0.5% decrease in one-to-four family residential loans.

The following table details our five largest lending relationships at March 31, 2014:

| Borrower [1] | Number of Loans | One-to-Four Family Residential (Rental Properties) (In thousands) | Multifamily | Commercial Real Estate (Rental Properties) | Construction/Land Development | Aggregate Balance of Loans [2] |
|---|---|---|---|---|---|---|
| Real estate investor | 3 | $— | $— | $18,321 | $ — | $18,321 |
| Real estate builder | 63 | 15,200 | — | — | 2,756 | 17,956 |
| Real estate builder [3] | 91 | 14,161 | — | 212 | — | 14,373 |
| Real estate investor | 34 | 8,464 | 3,951 | 1,689 | — | 14,104 |
| Real estate investor | 2 | — | — | 13,636 | — | 13,636 |
| Total | 193 | $37,825 | $3,951 | $33,858 | $ 2,756 | $78,390 |

(1) The composition of borrowers represented in the table may change between periods.
(2) Net of LIP.
(3) Of this amount, $13.2 million were considered impaired loans; and all of these loans were performing and consisted of one-to-four family residential loans.

These relationships, which represent 11.4% of our loans, net of undisbursed funds, decreased $1.2 million from December 31, 2013. All five borrowers were current on their loan payments at March 31, 2014. We monitor the performance of these borrowing relationships very closely due to the concentration risk they possess in relation to the entire loan portfolio.

Critical Accounting Policies

Our significant accounting policies are fundamental to understanding our results of operations and financial condition because they require that we use estimates and assumptions that may affect the value of our assets or liabilities and our financial results. These policies are critical because they require management to make difficult, subjective and complex judgments about matters that are inherently uncertain and because it is likely that materially different amounts would be reported under different conditions or using different assumptions. These policies govern the allowance for loan and lease losses ("ALLL"), the valuation of OREO and foreclosed assets, and the calculation of deferred taxes, fair values and other-than-temporary impairments on the market value of investments. These policies

and estimates are described in further detail in Part II, Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations and Note 1, Summary of Significant Accounting Policies with the 2013 Form 10-K. There have not been any material changes in the Company's critical accounting policies and estimates as compared to the disclosure contained in the Company's 2013 Form 10-K

Comparison of Financial Condition at March 31, 2014 and December 31, 2013

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Assets. Total assets were $901.5 million at March 31, 2014, a decrease of $19.5 million, or 2.1% from $921.0 million at December 31, 2013. The following table details the changes in the composition of our assets at March 31, 2014 from December 31, 2013.

| | Balance at March 31, 2014 | Increase/(Decrease) from December 31, 2013 | Percent Increase/(Decrease) |
|---|---|---|---|
| | (Dollars in thousands) | | |
| Cash on hand and in banks | $5,440 | $(634) | (10.4)% |
| Interest-earning deposits | 28,073 | (21,428) | (43.3) |
| Investments available-for-sale, at fair value | 139,868 | (4,496) | (3.1) |
| Loans receivable, net | 671,848 | 8,695 | 1.3 |
| Premises and equipment, net | 17,139 | (152) | (0.9) |
| FHLB stock, at cost | 6,952 | (65) | (0.9) |
| Accrued interest receivable | 3,509 | (189) | (5.1) |
| Deferred tax assets, net | 13,124 | (1,711) | (11.5) |
| OREO | 11,609 | 144 | 1.3 |
| Prepaid expenses and other assets | 3,917 | 336 | 9.4 |
| Total assets | $901,479 | $(19,500) | (2.1)% |

Interest-earning deposits decreased $21.4 million to $28.1 million at March 31, 2014, from $49.5 million at December 31, 2013 to fund the decline in customer deposits. Investments available-for-sale decreased $4.5 million, or 3.1% to $139.9 million at March 31, 2014, from $144.4 million at December 31, 2013, primarily due to the principal repayment of $5.0 million of mortgage-backed securities. Net loans receivable increased $8.7 million to $671.8 million at March 31, 2014 from December 31, 2013. Loan originations for the quarter were $38.9 million, of which $10.3 million and $13.2 million were in one-to-four family residential and commercial real estate loans, respectively. Principal repayments for the loan portfolio during the quarter were $30.5 million and loans transferred to OREO were $1.2 million. OREO increased $144,000 or 1.3% to $11.6 million at March 31, 2014, from $11.5 million at December 31, 2013 as more loans became OREO than OREO properties that were sold.

Deposits. During the first three months of 2014, deposits decreased $25.0 million to $587.0 million at March 31, 2014, compared to $612.1 million at December 31, 2013. Deposit accounts consisted of the following:

| | Balance at March 31, 2014 | Increase/ (Decrease) from December 31, 2013 | Percent Increase/(Decrease) |
|---|---|---|---|
| | (Dollars in thousands) | | |
| Noninterest-bearing | $8,810 | $(1,809) | (17.0)% |
| NOW | 21,238 | (4,233) | (16.6) |
| Statement savings | 22,178 | 1,782 | 8.7 |
| Money market | 136,857 | (8,315) | (5.7) |
| Certificates of deposit | 397,964 | (12,443) | (3.0) |
| | $587,047 | $(25,018) | (4.1)% |

Statement savings increased by $1.8 million during the first quarter of 2014 offset by decreases of $1.8 million, $4.2 million, $8.3 million and $12.4 million in noninterest-bearing, NOW, money market accounts and certificates of deposit, respectively. The decrease in certificates of deposit and money market accounts was primarily the result of our strategy to utilize our excess liquidity, mainly cash, to reduce higher-cost deposits by competing less aggressively on deposit interest rates. We believe customers who were more interest rate sensitive elected to withdraw their funds to invest in higher yielding investment products, which contributed to the decline in our deposit balances. Included in the certificates of deposit balance at March 31, 2014 was $10.8 million in public funds. We did not have any brokered deposits at March 31, 2014 or December 31, 2013.

Advances. We use advances from the FHLB as an alternative funding source to manage funding costs, reduce interest rate risk and to leverage our balance sheet. Total FHLB advances at March 31, 2014 were $119.0 million, unchanged from December 31, 2013.

Stockholders' Equity. Total stockholders' equity increased $3.5 million, or 1.9% to $187.8 million at March 31, 2014 from $184.4 million at December 31, 2013. The increase was primarily the result of net income of $2.6 million generated during the first quarter ended March 31, 2014 and an improvement of $1.2 million in other comprehensive income from unrealized holding gains on available-for-sale securities.

Comparison of Operating Results for the Three Months Ended March 31, 2014 and 2013

Net Interest Income. Net interest income for the quarter ended March 31, 2014 increased $665,000 before provision to $8.1 million, as compared to $7.4 million for the same quarter in 2013. The increase was attributable to an increase of $114,000 in interest income and a decrease of $551,000 in interest expense. Average interest-earning assets increased $9.7 million to $852.8 million for the three months ended March 31, 2014, from the same quarter in 2013 primarily due to an increase in our net loans receivable. Average interest-bearing liabilities increased $16.6 million to $705.2 million for the first quarter of 2014 compared to the first quarter of 2013, primarily due to an increase in our FHLB borrowings. During the same period, our yield on interest-earning assets did not change while our cost of funds decreased 34 basis points. Our interest rate spread for the quarter ended March 31, 2014 increased 34 basis points to 3.62% compared to 3.28% for the first quarter of 2013. Our net interest margin for the first quarter of 2014 increased 27 basis points to 3.78% from 3.51% for the same quarter last year.

The following table sets forth the effects of changes in rates and volumes on our net interest income:

| | Three Months Ended March 31, 2014 Compared to March 31, 2013 Increase/(Decrease) Due to | | |
|---|---|---|---|
| | Rate | Volume | Total |
| | (Dollars in thousands) | | |
| Interest-earning assets: | | | |
| Loan receivable, net | $(324) | $306 | $(18) |
| Investments available-for-sale | 157 | (26) | 131 |
| Interest-earning deposits | (1) | — | (1) |
| FHLB stock | 2 | — | 2 |
| Total net change in income on interest-earning assets | (166) | 280 | 114 |
| Interest-bearing liabilities: | | | |
| NOW | (1) | 3 | 2 |
| Statement savings | (2) | 1 | (1) |
| Money market | (14) | (11) | (25) |
| Certificates of deposit | (306) | (216) | (522) |
| Advances from the FHLB | (450) | 445 | (5) |
| Total net change in expense on interest-bearing liabilities | (773) | 222 | (551) |
| Net change in net interest income | $607 | $58 | $665 |

Interest Income. Total interest income for the first quarter of 2014 increased $114,000, or 1.2% to $9.7 million from $9.5 million, as compared to the first quarter of 2013.

The following table compares detailed average interest-earning asset balances, associated yields and resulting changes in interest and dividend income for the three months ended March 31, 2014 and 2013:

| | Three Months Ended March 31, | | | | | | |
|---|---|---|---|---|---|---|---|
| | 2014 | | | 2013 | | | Increase/(Decrease) in Interest and Dividend Income |
| | Average Balance | Yield | | Average Balance | Yield | | |
| | (Dollars in thousands) | | | | | | |
| Loans receivable, net | $670,311 | 5.39 | % | $650,955 | 5.56 | % | $ (18 ) |
| Investments available-for-sale | 142,473 | 1.70 | | 151,013 | 1.25 | | 131 |
| Interest-bearing deposits | 33,063 | 0.24 | | 33,880 | 0.25 | | (1 ) |
| FHLB stock | 7,001 | 0.10 | | 7,271 | — | | 2 |
| Total interest-earning assets | $852,848 | 4.53 | % | $843,119 | 4.53 | % | $ 114 |

Interest income from net loans receivable declined $18,000 and remained at $9.0 million during the first three months of 2014, as compared to the same period in 2013. The slight decline was due to a 17 basis point decrease in the average loan yield from the comparable quarter in 2013 offsetting a $19.4 million increase in the average loan balance to $670.3 million at March 31, 2014.

Interest income from investments available-for-sale increased $131,000 to $604,000 for the three months ended March 31, 2014, as compared to $473,000 for the comparable period in 2013. The primary reason for this increase was a 45 basis points increase in the average investment yield, resulting in a $157,000 increase in interest income, reflecting adjustable rate mortgage backed securities trending upwards over the last year. This change was partially offset by a $26,000 decrease in interest income due to a $8.5 million decrease in the average balance of investments.

Interest Expense. Total interest expense for the three months ended March 31, 2014 was $1.6 million, a decrease of $551,000 compared to $2.1 million for the first quarter of 2013.

The following table details average balances, cost of funds and the resulting decrease in interest expense for the three months ended March 31, 2014 and 2013:

| | Three Months Ended March 31, | | | | | | |
|---|---|---|---|---|---|---|---|
| | 2014 | | | 2013 | | | Increase/ (Decrease) in Interest Expense |
| | Average Balance | Cost | | Average Balance | Cost | | |
| | (Dollars in thousands) | | | | | | |
| NOW | $22,009 | 0.14 | % | $16,455 | 0.15 | % | $2 |
| Statement savings | 22,349 | 0.13 | | 18,304 | 0.20 | | (1 ) |
| Money market | 138,161 | 0.18 | | 158,468 | 0.22 | | (25 ) |
| Certificates of deposit | 403,652 | 1.26 | | 458,348 | 1.56 | | (522 ) |
| Advances from the FHLB | 119,000 | 0.84 | | 37,007 | 2.77 | | (5 ) |
| Total interest-bearing liabilities | $705,171 | 0.91 | % | $688,582 | 1.25 | % | $(551 ) |

Interest expense on our certificates of deposit accounts decreased $522,000, due to the $54.7 million decline in the average balance of certificates of deposit and a 30 basis point reduction in our cost of certificates for the first quarter

of 2014, as compared to the first quarter of 2013. Interest expense on our money market accounts decreased $25,000, primarily as a result of a decrease in the average cost of these funds of four basis points, or $14,000 to 0.18% from 0.22%. Interest expense related to our FHLB advances decreased $5,000, primarily as a result of the 193 basis points decrease in our average cost of funds for FHLB advances to 0.84% at March 31, 2014 from 2.77% at March 31, 2013 being mostly offset by an increase of $82.0 million in the average balance of our advances to $119.0 million for the first quarter of 2014, as compared to $37.0 million during the quarter ended March 31, 2013.

Provision for Loan Losses. Management recognizes that loan losses may occur over the life of a loan and that the ALLL must be maintained at a level necessary to absorb specific losses on impaired loans and probable losses inherent in the loan portfolio. Our methodology for analyzing the ALLL consists of two components: general and specific allowances. The general allowance

is determined by applying factors to our various groups of loans. Management considers factors such as charge-off history, the prevailing economy, borrower's ability to repay, the regulatory environment, competition, geographic and loan type concentrations, policy and underwriting standards, nature and volume of the loan portfolio, managements' experience level, our loan review and grading systems, the value of underlying collateral and the level of problem loans in assessing the ALLL. The specific allowance component is created when management believes that the collectability of a specific loan, has been impaired and a loss is probable. The specific reserves are computed using current appraisals, listed sales prices and other available information less costs to complete, if any, and costs to sell the property. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available or as future events differ from predictions.

During the quarter ended March 31, 2014, management evaluated the adequacy of the ALLL and concluded that a recapture of prior period provisions for loan loss in the amount of $500,000 was appropriate for the quarter, compared to no provision during the quarter ended March 31, 2013:

- after careful review and ongoing monitoring, loans with principal balances totaling $12.3 million were upgraded during the quarter as a result of an improvement in their respective risk profiles, reducing the amounts allocated for future loan losses relating to these loans;
- delinquent loans, loans over 30 days past due, decreased to $3.0 million at March 31, 2014, from $4.3 million at December 31, 2013 and $16.7 million at March 31, 2013;
- nonperforming loans decreased to $2.5 million at March 31, 2014, from $4.0 million at December 31, 2013, and $19.0 million at March 31, 2013, reflecting continuing improvement in the quality of our loan portfolio;
- nonperforming loans as a percentage of total loans improved to 0.37% at March 31, 2014, compared to 0.59% at December 31, 2013, and 2.86% at March 31, 2013; and
- nonperforming assets decreased to $14.1 million at March 31, 2014, compared to $15.5 million at December 31, 2013, and $35.3 million at March 31, 2013.

The ALLL at March 31, 2014, was $12.1 million compared to $13.0 million at December 31, 2013. The ALLL represented 477.23% of nonperforming loans and 1.76% of total loans, net of LIP, at March 31, 2014 compared to 325.26% and 1.91%, respectively, at December 31, 2013.

We believe that the ALLL as of March 31, 2014 was adequate to absorb the probable and inherent risks of loss in the loan portfolio at that date. While we believe the estimates and assumptions used in our determination of the adequacy of the allowance are reasonable, there can be no assurance that such estimates and assumptions will be proven correct in the future, that the actual amount of future provisions will not exceed the amount of past provisions or that any increased provisions that may be required will not adversely impact our financial condition and results of operations. Future additions to the allowance may become necessary based upon changing economic conditions, the level of problem loans, business conditions, credit concentrations, increased loan balances, or changes in the underlying collateral of the loan portfolio. In addition, the determination of the amount of our ALLL is subject to review by bank regulators as part of the routine examination process, which may result in the establishment of additional loss reserves or the charge-off of specific loans against established loss reserves based upon their judgment of information available to them at the time of their examination.

The following table presents a breakdown of our nonperforming assets and as a percent of total assets at the dates indicated:

| | March 31, 2014 | December 31, 2013 | March 31, 2013 | Three Month Increase/(Decrease) | One Year Increase/ (Decrease) |
|---|---|---|---|---|---|
| | (Dollars in thousands) | | | | |
| Nonperforming loans: | | | | | |
| One-to-four family residential | $ 1,600 | $ 2,297 | $ 5,980 | $ (697) | $ (4,380) |
| Multifamily | 228 | 233 | 2,623 | (5) | (2,395) |
| Commercial real estate | 706 | 1,198 | 4,883 | (492) | (4,177) |
| Construction/land development | — | 223 | 4,747 | (223) | (4,747) |
| Consumer | — | 44 | 732 | (44) | (732) |
| Total nonperforming loans | 2,534 | 3,995 | 18,965 | (1,461) | (16,431) |
| | | | | | |
| OREO | 11,609 | 11,465 | 16,310 | 144 | (4,701) |
| Total nonperforming assets | $ 14,143 | $ 15,460 | $ 35,275 | $ (1,317) | $ (21,132) |
| | | | | | |
| Nonperforming assets as a percent of total assets | 1.57 % | 1.68 % | 3.98 % | | |

Nonperforming loans include loans to borrowers who are experiencing deteriorating financial conditions and there is doubt as to the ultimate recoverability of the full principal and interest due the Bank in accordance with the terms of the loan agreement. Nonperforming loans decreased $1.5 million to $2.5 million at March 31, 2014, from $4.0 million at December 31, 2013. This decrease was the result of $1.2 million of loans transferred to OREO, $553,000 in charge-offs, $215,000 in short sales and $60,000 in principal reductions offset by a net increase of $558,000 of loans classified as nonperforming during the three months ended March 31, 2014.

The three largest nonperforming loans in the loan portfolio at March 31, 2014 consisted of a $601,000 commercial loan, secured by a two-story office building in King County; a $326,000 one-to-four family loan secured by a two-story single family residence in Pierce County; and a $300,000 one-to-four family loan, secured by a two-story single family residence in Pierce County.

Nonperforming assets continued to decrease during the quarter. At their peak, nonperforming assets reached $166.4 million at March 31, 2010, decreasing to $14.1 million at March 31, 2014, representing a $152.3 million, or 91.5% decrease.

The following table presents a breakdown of our TDRs:

| | March 31, 2014 | December 31, 2013 | March 31, 2013 | Three Month Increase/ (Decrease) | One Year Increase/ (Decrease) |
|---|---|---|---|---|---|
| | (In thousands) | | | | |
| Nonperforming TDRs: | | | | | |
| One-to-four family residential | $ 469 | $ 924 | $ 2,679 | $ (455) | $ (2,210) |
| Consumer | — | 44 | 47 | (44) | (47) |
| Total nonperforming TDRs | 469 | 968 | 2,726 | (499) | (2,257) |
| | | | | | |
| Performing TDRs: | | | | | |
| One-to-four family residential | 45,762 | 45,851 | 52,270 | (89) | (6,508) |
| Multifamily | 2,201 | 2,208 | 1,234 | (7) | 967 |
| Commercial real estate | 12,066 | 12,111 | 12,251 | (45) | (185) |
| Consumer | 43 | — | — | 43 | 43 |
| Total performing TDRs | 60,072 | 60,170 | 65,755 | (98) | (5,683) |

| | | | | | |
|---|---|---|---|---|---|
| Total TDRs | $60,541 | $61,138 | $68,481 | $(597) | $(7,940) |

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Our TDRs decreased $597,000, or 1.0% to $60.5 million at March 31, 2014, compared to $61.1 million at December 31, 2013 and decreased $7.9 million, or 11.6% as compared to $68.5 million at March 31, 2013. During the first three months of 2014, we did not transfer any nonperforming TDRs to OREO, while $345,000 of TDRs were paid off and $252,000 in principal payments were received.

As we work with our borrowers to help them through this difficult economic cycle, we explore all options available to minimize our risk of loss. At times, the best option for our customers and the Bank is to modify the loan for a period of time, usually one year or less. These modifications have included lowering the interest rate on the loan for a period of time and/or extending the maturity date of the loan or allowing interest only payments for a specific time frame. These modifications are granted only when there is a reasonable and attainable restructured loan plan that has been agreed to by the borrower and is in the Bank's best interest. Of the $60.5 million in TDRs at March 31, 2014, $60.1 million were performing and $469,000 were not performing according to their restructured payment terms.

The largest TDR relationship at March 31, 2014 totaled $13.2 million and was comprised of one-to-four family residential rental properties located in King, Kitsap, Pierce and Thurston counties. At March 31, 2014, there were no LIP in connection with these restructured and impaired loans.

OREO includes properties acquired by the Bank through foreclosure or deed in lieu of foreclosure. The following table presents a breakdown of our OREO by county and number of properties at March 31, 2014.

| | County | | | | Total | Number of Properties | Percent of Total OREO |
|---|---|---|---|---|---|---|---|
| | King | Pierce | Kitsap | All Other | | | |
| | (Dollars in thousands) | | | | | | |
| OREO: | | | | | | | |
| One-to-four family residential | $711 | $505 | $— | $— | $1,216 | 7 | 10.5 % |
| Commercial real estate [1] | — | 8,152 | 773 | 912 | 9,837 | 13 | 84.7 % |
| Construction/land development | — | 223 | — | 333 | 556 | 2 | 4.8 % |
| Total OREO | $711 | $8,880 | $773 | $1,245 | $11,609 | 22 | 100.0 % |

[1] Of the 13 properties classified as commercial real estate, there are nine office/retail buildings, one mixed-use buildings
and three are undeveloped lots.

The following table presents a breakdown of our OREO activity:

| | Three Months Ended March 31, | |
|---|---|---|
| | 2014 | 2013 |
| | (In thousands) | |
| Balance at beginning of period | $11,465 | $17,347 |
| Loans transferred to OREO | 1,191 | 3,376 |
| Capitalized improvements | — | 33 |
| Dispositions of OREO | (851) | (4,301) |
| Market value adjustments | (196) | (145) |
| Balance at end of period | $11,609 | $16,310 |

OREO increased $144,000 during the first quarter of 2014, or 1.3% to $11.6 million at March 31, 2014 from December 31, 2013. We sold $851,000 of OREO during the first quarter of 2014, which was comprised of two properties and generated a net loss on sale of $71,000. OREO at March 31, 2014 consisted of $9.8 million in commercial real estate properties, $1.2 million in one-to-four family residential homes and $556,000 in

construction/land development projects.

The three largest OREO properties at March 31, 2013 were an office/retail building valued at $3.4 million, an office/retail building valued at $1.1 million and an office/retail building valued at $837,000, all located in Pierce County.

We continue to focus our efforts on converting nonperforming loans to OREO through foreclosure or deeds in lieu of foreclosure and selling the properties. By taking ownership of these properties, we can convert nonearning assets into earning

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assets on a more timely basis. Our success in this area is reflected by the improved ratio of our average interest-earning assets to average interest-bearing liabilities of 120.9% at March 31, 2014 compared to 122.4% at March 31, 2013.

The following table summarizes selected financial data related to our ALLL and loan portfolio. All loan balances and ratios are calculated using loan balances that are net of LIP.

| | At or For the Three Months Ended March 31, | |
|---|---|---|
| | 2014 | 2013 |
| | (Dollars in thousands) | |
| Recapture of loan loss provision | $500 | $— |
| Charge-offs | 553 | 619 |
| Recoveries | 152 | 79 |
| ALLL | 12,093 | 12,002 |
| ALLL as a percent of total loans, net of LIP | 1.76% | 1.81% |
| ALLL as a percent of nonperforming loans, net of LIP | 477.23 | 63.28 |
| Total nonperforming loans, net of LIP | $2,534 | $18,965 |
| Nonperforming loans as a percent of total loans, net of LIP | 0.37% | 2.86% |
| Total loans receivable, net of LIP | $686,565 | $663,499 |
| Total loans originated | 38,884 | 28,552 |

Noninterest Income. Noninterest income decreased $36,000 to $68,000 for the first quarter of 2014 from $104,000 for the same quarter in 2013. The following table provides a detailed analysis of the changes in the components of noninterest income:

| | Three Months Ended March 31, 2014 | Increase/(Decrease) from March 31, 2013 | Percent Increase/(Decrease) |
|---|---|---|---|
| | (Dollars in thousands) | | |
| Service fees on deposit accounts | $15 | $(2) | (11.5)% |
| Loan service fees | 21 | (14) | (41.0) |
| Servicing rights, net | 2 | 5 | (158.8) |
| Other | 30 | (25) | (44.7) |
| Total noninterest income | $68 | $(36) | (34.7)% |

The decrease in noninterest income for three months ended March 31, 2014 compared to the same period in 2013 was largely due to a $23,000 decrease in rental income from OREO properties.

Noninterest Expense. Noninterest expense decreased $1.4 million to $4.5 million for the first quarter of 2014 from $5.9 million for the comparable quarter in 2013. The following table provides a detailed analysis of the changes in the components of noninterest expense:

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| | Three Months Ended March 31, 2014 (Dollars in thousands) | Increase/(Decrease) from March 31, 2013 | Percent Increase/(Decrease) |
|---|---|---|---|
| Salaries and employee benefits | $2,900 | $(714) | (19.7)% |
| Occupancy and equipment | 351 | (3) | (0.9) |
| Professional fees | 357 | (88) | (19.7) |
| Data processing | 173 | 11 | 6.7 |
| Loss on sales of OREO property, net | 71 | 703 | (111.2) |
| OREO market value adjustments | 196 | 51 | 35.1 |
| OREO-related expenses, net | 61 | (273) | (81.7) |
| Regulatory assessments | 78 | (205) | (72.4) |
| Insurance and bond premiums | 88 | (26) | (22.7) |
| Marketing | 25 | 7 | 39.6 |
| Prepayment penalty on FHLB advances | — | (679) | (100.0) |
| Other general and administrative | 224 | (138) | (38.1) |
| Total noninterest expense | $4,524 | $(1,354) | (23.0)% |

The decrease in noninterest expense for the three months ended March 31, 2014 compared to the same period in 2013 was in part due to the FHLB prepayment penalty of $679,000 incurred during the quarter ended March 31, 2013 on the refinance of a $33.0 million advance with no comparable transaction during the quarter ending March 31, 2013. In addition, salaries and employee benefits decreased $714,000, as compared to the first quarter of last year due to 15.2% reduction in full-time equivalent employees to 95 from 112 employees. Also contributing to the change was a decline in stock based compensation, which was $85,000 during the quarter ended March 31, 2014 compared to $481,000 in the comparable quarter a year ago. The Bank also had decreases of $273,000 in OREO-related expenses and a $205,000 decrease in our regulatory assessments reflecting our improved financial condition. In addition, we had a net loss on sales of OREO property of $71,000 in the first quarter of 2014 compared to a net gain of $632,000 during the first quarter of 2013 .

Federal Income Tax Expense. We recorded a $1.5 million federal income tax provision for the quarter ended March 31, 2014, as a result of our increase in net income. This compared to $59,000 federal income tax provision for the three months ended March 31, 2013. The federal income tax provision for the three months ended March 31, 2013 was the result of the alternative minimum tax. For the three months ended March 31, 2014, the effective tax rate was 35.46%

Liquidity

We are required to have enough cash flow in order to maintain sufficient liquidity to ensure a safe and sound operation. We maintain cash flows above the minimum level believed to be adequate to meet the requirements of normal operations, including potential deposit outflows. On a daily basis, we review and update cash flow projections to ensure that adequate liquidity is maintained.

Our primary sources of funds are customer deposits, loan and investment repayments, maturing investment securities and advances from the FHLB. These funds, together with equity, are used to make loans, acquire investment securities and other assets, and fund continuing operations. At March 31, 2014, certificates of deposit scheduled to mature in one year or less totaled $244.3 million. Management's policy is to maintain deposit rates at levels that are competitive with other local financial institutions, although recently we have been less aggressive in competing for certificates of

deposit and public funds in order to reduce our cost of funds. Historically, we have been able to retain a significant amount of the deposits as they mature. While maturities and the scheduled amortization of loans are a predictable source of funds, deposit flows and mortgage prepayments are greatly influenced by the level of interest rates, economic conditions and competition. We measure our liquidity based on our ability to fund our assets and to meet liability obligations when they come due. Liquidity (and funding) risk occurs when funds cannot be raised at reasonable prices or in a reasonable time frame to meet our normal or unanticipated obligations. We regularly monitor the mix between our assets and our liabilities to manage effectively our liquidity and funding requirements.

When deposits are not readily available and/or cost effective to provide the funds for our assets, we use alternative funding sources. These sources include, but are not limited to: advances from the FHLB, wholesale funding, brokered deposits, federal funds purchased and dealer repurchase agreements, as well as other short-term alternatives. These funding sources are generally collateral dependent. We may also liquidate assets to meet our funding needs. At March 31, 2014, the Bank maintained credit

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facilities with the FHLB totaling $228.6 million with an outstanding balance of $119.0 million. At March 31, 2014, we also had available a total of $50.0 million credit facilities with other financial institutions, with no balance outstanding. For additional information, see the Consolidated Statements of Cash Flow in Item 1 of this Form 10-Q.

On a monthly basis, we estimate our liquidity sources and needs for the next six months. Also, we determine funding concentrations and our need for sources of funds other than deposits. This information is used by our Asset/Liability Management Committee in forecasting funding needs and investing opportunities. We believe that our current liquidity position and our expected operating results are sufficient to fund all of our existing commitments

Commitments and Off-Balance Sheet Arrangements

We are a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of our customers. These financial instruments include commitments to extend credit and the unused portions of lines of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated financial statements. Commitments to extend credit and lines of credit are not recorded as an asset or liability by us until the instrument is exercised. At March 31, 2014 and December 31, 2013, we had no commitments to originate loans for sale.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the loan agreement. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. We evaluate each customer's creditworthiness on a case-by-case basis. The amount of the collateral obtained, if deemed necessary by us upon extension of credit, is based on our credit evaluation of the customer. The amount and type of collateral required varies, but may include real estate and income-producing commercial properties.

The following table summarizes our outstanding commitments to originate loans, to advance additional amounts pursuant to outstanding lines of credit and to disburse funds related to our construction loans at March 31, 2014.

| | | Amount of Commitment Expiration - Per Period | | | |
|---|---|---|---|---|---|
| | Total Amounts Committed | Through One Year | After One Through Three Years | After Three Through Five Years | After Five Years |
| | (In thousands) | | | | |
| Commitments to originate loans | $8,158 | $8,158 | $— | $— | $— |
| Unused portion of lines of credit | 11,232 | 1,992 | 298 | 6,889 | 2,053 |
| Undisbursed portion of construction loans | 11,339 | 7,303 | 4,036 | — | — |
| Total commitments | $30,729 | $17,453 | $4,334 | $6,889 | $2,053 |

First Financial Northwest and its subsidiaries from time to time are involved in various claims and legal actions arising in the ordinary course of business. There are currently no matters that in the opinion of management, would have a material adverse effect on First Financial Northwest’s consolidated financial position, results of operation or liquidity.

Among our contingent liabilities are exposures to limited recourse arrangements with respect to sales of whole loans and participation interests.

We anticipate that we will continue to have sufficient funds and alternative funding sources to meet our current commitments.

Capital

At March 31, 2014, stockholders' equity totaled $187.8 million, or 20.8% of total assets. Our book value per share of common stock was $11.42 at March 31, 2014 compared to $11.25 at December 31, 2013. Consistent with our goal to operate a sound and profitable financial organization, we actively seek to maintain a “well-capitalized” institution in accordance with regulatory standards. As of March 31, 2014, the Bank exceeded all regulatory capital requirements. Regulatory capital ratios for the Bank only were as follows at March 31, 2014: Tier 1 leverage capital 18.61%; Tier 1 risk-based capital 26.98%; and Total risk-based capital 28.24%. The regulatory capital requirements to be considered well capitalized are 5%, 6% and 10%, respectively.

The Bank met the financial ratios for "well-capitalized" status at March 31, 2014. In addition, at March 31, 2014, First Financial Northwest, the parent company of the Bank, had $10.4 million of available cash to potentially increase its investment in the Bank.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

General. Our Board of Directors has approved an asset/liability management policy to guide management in maximizing net interest income by managing the differences in terms between interest-earning assets and interest-bearing liabilities while maintaining acceptable levels of liquidity, capital adequacy, interest rate sensitivity, credit risk and profitability. The policy established an Asset/Liability Management Committee ("ALCO") comprised of certain members of senior management and the Board of Directors. The Committee's purpose is to communicate, coordinate and manage our asset/liability position consistent with our business plan and Board-approved policies. The ALCO meets quarterly to review various areas including:

- economic conditions;
- interest rate outlook;
- asset/liability mix;
- interest rate risk sensitivity;
- current market opportunities to promote specific products;
- historical financial results;
- projected financial results; and
- capital position.

The Committee also reviews current and projected liquidity needs. As part of its procedures, the ALCO regularly reviews interest rate risk by forecasting the impact that changes in interest rates may have on net interest income and the market value of portfolio equity, which is defined as the net present value of an institution's existing assets, liabilities and off-balance sheet instruments and evaluating such impacts against the maximum potential change in the market value of portfolio equity that is authorized by the Board of Directors.

Our Risk When Interest Rates Change. The rates of interest we earn on assets and pay on liabilities generally are established contractually for a period of time. Market interest rates change over time. Our loans generally have longer maturities than our deposits. Accordingly, our results of operations, like those of other financial institutions, are impacted by changes in interest rates and the interest rate sensitivity of our assets and liabilities. The risk associated with changes in interest rates and our ability to adapt to these changes is known as interest rate risk and is our most significant market risk.

We have utilized the following strategies in our efforts to manage interest rate risk:

- we have attempted, where possible, to extend the maturities of our deposits which typically fund our long-term assets;
- we have invested in securities with relatively short average lives, generally less than eight years; and
- we have added adjustable-rate securities to our investment portfolio.

How We Measure the Risk of Interest Rate Changes. We monitor our interest rate sensitivity on a quarterly basis to measure the change in net interest income as a percentage of net income in varying rate environments. Management uses various assumptions to evaluate the sensitivity of our operations to changes in interest rates. Although management believes these assumptions are reasonable, the interest rate sensitivity of our assets and liabilities on net interest income and the market value of portfolio equity could vary substantially if different assumptions were used or actual experience differs from these assumptions. Although certain assets and liabilities may have similar maturities or periods of repricing, they may react differently to changes in market interest rates. The interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types of assets and liabilities lag behind changes in market interest rates. Non-uniform changes and fluctuations in market interest rates across various maturities will also affect the results presented. In addition, certain assets, such as

adjustable-rate mortgage loans, have features which restrict changes in interest rates on a short-term basis and over the life of the asset. Further, a portion of our adjustable-rate loans have interest rate floors below which the loan's contractual interest rate may not adjust. Approximately 25.4% of our total loans were comprised of adjustable-rate loans at March 31, 2014. At that date, $77.7 million, or 43.8% of these loans with a weighted-average interest rate of 4.4% were at their floor interest rate. The inability of our loans to adjust downward can contribute to increased income in periods of declining interest rates. Also, when loans are at their floors, there is a further risk that our interest income may not increase as rapidly as our cost of funds during periods of increasing interest rates. Further, in the event of a significant change in interest rates, prepayment and early withdrawal levels would likely deviate from those assumed. Finally, the ability of many borrowers to service their debt may decrease in the event of an interest rate increase. We consider all these factors in monitoring our interest rate exposure.



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The assumptions we use are based upon a combination of proprietary and market data that reflect historical results and current market conditions. These assumptions relate to interest rates, loan prepayments, deposit decay rates and the market value of certain assets under the various interest rate scenarios. We use market data to determine prepayments and maturities of loans, investments and borrowings and use our own assumptions on deposit decay rates except for time deposits. Time deposits are modeled to reprice to market rates upon their stated maturities. We also assume that non-maturity deposits can be maintained with rate adjustments not directly proportionate to the change in market interest rates, based upon our historical deposit decay rates which are substantially lower than market decay rates. We have demonstrated in the past that the tiering structure of our deposit accounts during changing rate environments results in relatively lower volatility and less than market rate changes in our interest expense for deposits. We tier our deposit accounts by balance and rate, whereby higher balances within an account earn higher rates of interest. Therefore, deposits that are not very rate sensitive (generally, lower balance tiers) are separated from deposits that are rate sensitive (generally, higher balance tiers). When interest rates rise, we do not have to raise interest rates proportionately on less rate sensitive accounts to retain these deposits. These assumptions are based upon our analysis of our customer base, competitive factors and historical experience.

Our income simulation model examines changes in net interest income in which interest rates were assumed to remain at their base level, instantaneously increase by 100, 200 and 300 basis points or decline immediately by 100 basis points. Reductions of rates by 200 and 300 basis points were not reported due to the very low rate environment. The current federal funds rate is 0.25% making a 200 and 300 basis point decrease impossible.

The following table illustrates the change in our net interest income at March 31, 2014 that would occur in the event of a gradual change in interest rates equally across all maturities, with no effect given to any steps that we might take to counter the effect of that interest rate movement.

Net Interest Income Change at March 31, 2014

| Basis Point Change in Rates | Net Interest Income | % Change |
|---|---|---|
| (Dollars in thousands) | | |
| +300 | $ 30,761 | (3.09)% |
| +200 | 31,216 | (1.66) |
| +100 | 31,610 | (0.42) |
| Base | 31,742 | — |
| (100) | 30,641 | (3.47) |

The following table illustrates the change in our net portfolio value (“NPV”) at March 31, 2014 that would occur in the event of an immediate change in interest rates equally across all maturities, with no effect given to any steps that we might take to counter the effect of that interest rate movement.

| Basis Point Change in Rates [1] | Net Portfolio Value (2) Amount | $ Change (3) | % Change | Net Portfolio as % of Portfolio Value of Assets NPV Ratio [4] | % Change [5] | Market Value of Assets [6] |
|---|---|---|---|---|---|---|
| | (Dollars in thousands) | | | | | |
| +300 | $ 148,357 | $ (45,942) | (23.60)% | 17.74 % | (5.03)% | $ 836,279 |
| +200 | 163,507 | (30,792) | (15.80) | 18.98 | (3.37) | 861,330 |
| +100 | 179,834 | (14,465) | (7.40) | 20.25 | (1.58) | 887,977 |
| Base | 194,299 | — | — | 21.28 | — | 913,218 |
| (100) | 202,751 | 8,452 | 4.40 | 21.73 | 0.93 | 933,003 |

(1) The current federal funds rate is 0.25%, making a 200 and 300 basis point drop impossible.
(2) The net portfolio value is the difference between the present value of the discounted cash flows of assets and liabilities and represents the market value of the Company's equity for any given interest rate scenario. Net portfolio value is useful for determining, on a market value basis, how equity changes in response to various interest rate scenarios. Large changes in net portfolio value reflect increased interest rate sensitivity and generally more volatile earnings streams.
(3) The increase or decrease in the estimated net portfolio value at the indicated interest rates compared to the net portfolio value assuming no change in interest rates.
(4) Net portfolio value divided by the market value of assets.
(5) The increase or decrease in the net portfolio value divided by the market value of assets.
(6) The market value of assets represents the value of assets under the various interest rate scenarios and reflects the sensitivity of those assets to interest rate changes.

The net interest income and net portfolio value tables presented above are predicated upon a stable balance sheet with no growth or change in asset or liability mix. In addition, the net portfolio value is based upon the present value of discounted cash flows using our estimates of current replacement rates to discount the cash flows. The effects of changes in interest rates in the net interest income table are based upon a cash flow simulation of our existing assets and liabilities and assuming that delinquency rates would not change as a result of changes in interest rates, although there can be no assurance that this will be the case. Delinquency rates may change when interest rates change as a result of changes in the loan portfolio mix, underwriting conditions, loan terms or changes in economic conditions that have a delayed effect on the portfolio. Even if interest rates change in the designated amounts, there can be no assurance that our assets and liabilities would perform as set forth above. Also, a change in U.S. Treasury rates in the designated amounts accompanied by a change in the shape of the Treasury yield curve would cause changes to the net portfolio value and net interest income other than those indicated above.

At March 31, 2014, we did not have any derivative financial instruments or trading accounts for any class of financial instruments, nor have we engaged in hedging activities or purchased off-balance sheet derivative instruments. Interest rate risk continues to be one of our primary risks as other types of risks, such as foreign currency exchange risk and commodity pricing risk do not arise in the normal course of our business activities and operations.

Item 4. Controls and Procedures

The management of First Financial Northwest, Inc. is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rule 13a-15(f) of the Securities Exchange Act of 1934 (“Exchange Act”). A control procedure, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that its objectives are met. Also, because of the inherent limitations in all control procedures, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the

Company have been detected. Additionally, in designing disclosure controls and procedures, our management was required to apply its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures. The design of any disclosure controls and procedures is also based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. As a result of these inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Further, projections of any evaluation of effectiveness to future periods



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are subject to risk that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

(a) Evaluation of Disclosure Controls and Procedures: An evaluation of our disclosure controls and procedures (as defined in Rule 13a-15(e) of the Exchange Act) was carried out under the supervision and with the participation of our Chief Executive Officer, Chief Financial Officer (Principal Financial Officer) and several other members of our senior management as of the end of the period covered by this report. Our Chief Executive Officer and Chief Financial Officer concluded that, as of March 31, 2014, our disclosure controls and procedures were effective in ensuring that the information required to be disclosed by us in the reports we file or submit under the Exchange Act is (i) accumulated and communicated to our management (including the Chief Executive Officer and Chief Financial Officer) in a timely manner and (ii) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

(b) Changes in Internal Controls: In the quarter ended March 31, 2014, there was no change in our internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II

Item 1. Legal Proceedings

From time to time, we are engaged in various legal proceedings in the ordinary course of business, none of which are currently considered to have a material impact on our financial position or results of operations.

Item 1A. Risk Factors

There have been no material changes to the risk factors previously disclosed in Part I, Item 1A of 2013 Form 10-K.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

During the first quarter of 2014, we did not sell any securities that were not registered under the Securities Act of 1933. There were no repurchases of equity securities in the first quarter of 2014.

On April 24, 2014, the Company announced that its Board of Directors has authorized the repurchase of up to 1,645,414 shares of the Company's common stock, or 10% of the Company's outstanding shares. The shares may be purchased through September 16, 2014, depending upon market conditions and other factors.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

Not applicable.

Item 6. Exhibits and Financial Statement Schedules

(a) Exhibits

| | |
|---|---|
| 3.1 | Articles of Incorporation of First Financial Northwest [1] |
| 3.2 | Bylaws of First Financial Northwest [1] |
| 4.0 | Form of stock certificate of First Financial Northwest [1] |
| 10.1 | Amended Employment Agreement between First Savings Bank Northwest and Joseph W. Kiley III [11] |
| 10.2 | Form of Change in Control Severance Agreement for Executive Officers [1] |
| 10.3 | Form of First Savings Bank Employee Severance Compensation Plan [1] |
| 10.4 | Form of Supplemental Executive Retirement Agreement entered into by First Savings Bank with Victor Karpiak, Harry A. Blencoe, Robert H. Gagnier and Joseph W. Kiley III [1] |
| 10.5 | Form of Financial Institutions Retirement Fund [1] |
| 10.6 | Form of 401(k) Retirement Plan [2] |
| 10.7 | 2008 Equity Incentive Plan [3] |
| 10.8 | Forms of incentive and non-qualified stock option award agreements [4] |
| 10.9 | Form of restricted stock award agreement [4] |
| 10.9 | Form of restricted stock award agreement [4] |
| 10.10 | Memorandum of Understanding with the FDIC and DFI [5] |
| 10.11 | Settlement Agreement and Mutual Release with the Stilwell Group [6] |
| 10.12 | Transition Agreement Modification Agreement for Victor Karpiak [6] |
| 10.13 | Amendment No. 1 to the Settlement and Mutual Release Agreement with the Stilwell Group [7] |
| 10.14 | Amendment No. 2 to the Settlement and Mutual Release Agreement with the Stilwell Group [8] |
| 10.15 | Offer Letter, dated June 27, 2013, between First Savings Bank Northwest and Richard P. Jacobson [9] |
| 10.16 | Separation Agreement between Victor Karpiak, First Financial Northwest and Affiliates [10] |
| 10.17 | Employment Agreement between First Savings Bank Northwest and Richard P. Jacobson [11] |
| 31.1 | Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act |
| 31.2 | Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act |
| 32 | Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act |
| 101.0 | The following materials from First Financial Northwest's Quarterly Report on Form 10-Q for the quarter ended March 31, 2014, formatted in Extensible Business Reporting Language (XBRL): (1) Consolidated Balance Sheets; (2) Consolidated Income Statements; (3) Consolidated Statements of Comprehensive Income; (4) Consolidated Statements of Stockholders' Equity; (5) Consolidated Statements of Cash Flows; and (6) Selected Notes to Consolidated Financial Statements.* |

*Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933 or Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.

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[1] Filed as an exhibit to First Financial Northwest's Current Report on Form 8-K dated March 22, 2012.

[2] Filed as an exhibit to First Financial Northwest's Quarterly Report on Form 10-Q for the quarter ended June 30, 2007, and incorporated herein by reference.

[3] Filed as Appendix A to First Financial Northwest's definitive proxy statement dated April 15, 2008.

[4] Filed as an exhibit to First Financial Northwest's Current Report on Form 8-K dated March 22, 2012.

[5] Filed as an exhibit to First Financial Northwest's Current Report on Form 8-K dated April 2, 2012.

[6] Filed as an exhibit to First Financial Northwest's Current Report on Form 8-K dated December 20, 2012.

[7] Filed as an exhibit to First Financial Northwest's Current Report on Form 8-K dated January 17, 2013.

[8] Filed as an exhibit to First Financial Northwest's Current Report on Form 8-K dated February 26, 2013.

[9] Filed as an exhibit to First Financial Northwest's Current Report on Form 8-K dated July 9, 2013.

[10] Filed as an exhibit to First Financial Northwest's Current Report on Form 8-K dated August 23, 2013.

[11] Filed as an exhibit to First Financial Northwest's Current Report on Form 8-K dated December 5, 2013.

SIGNATURES

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

FIRST FINANCIAL NORTHWEST, INC.

| | |
|---|---|
| Date: May 8, 2014 | By: /s/ Joseph W. Kiley III<br>Joseph W. Kiley III<br>President and Chief Executive Officer (Principal Executive Officer) |
| Date: May 8, 2014 | By: /s/ Richard. P. Jacobson<br>Richard P. Jacobson<br>Chief Financial Officer (Principal Financial Officer) |
| Date: May 8, 2014 | By: /s/ Christine A. Huestis<br>Christine A. Huestis<br>Vice President and Controller (Principal Accounting Officer) |

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Exhibit Index

| Exhibit No. | Description |
|---|---|
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