

GOVERNMENT PROPERTIES TRUST INC

Form 10-Q

August 09, 2006

Table of Contents

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

FORM 10-Q

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2006
COMMISSION FILE NUMBER 001-31962**

GOVERNMENT PROPERTIES TRUST, INC.

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

MARYLAND
(State or other jurisdiction of
incorporation or organization)

20-0611663
(I.R.S. Employer
Identification No.)

13625 CALIFORNIA STREET, SUITE 310
OMAHA, NEBRASKA 68154
(Address of principal executive
offices, including zip code)

(402) 391-0010
(Registrant's telephone number,
including area code)

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

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

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12-b-2 of the Exchange Act).

Yes No

As of August 1, 2006, approximately 20.8 million shares of common stock of the registrant were outstanding.

TABLE OF CONTENTS

	PAGE
PART I FINANCIAL INFORMATION	
Item 1. Consolidated Financial Statements (unaudited)	
<u>Consolidated Balance Sheets as of June 30, 2006 (unaudited) and December 31, 2005</u>	3
<u>Consolidated Statements of Operations and Comprehensive Income for the three and six months ended June 30, 2006 and 2005 (unaudited)</u>	4
<u>Consolidated Statements of Cash Flows for the six months ended June 30, 2006 and 2005 (unaudited)</u>	5
<u>Notes to Consolidated Financial Statements (unaudited)</u>	6
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	11
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	19
<u>Item 4. Controls and Procedures</u>	19
 PART II OTHER INFORMATION	
Item 1. Not Applicable	
<u>Item 1A. Risk Factors</u>	20
Item 2. Not Applicable	
Item 3. Not Applicable	
<u>Item 4. Submission of Matters to a Vote of Security Holders</u>	20
Item 5. Not Applicable	
<u>Item 6. Exhibits</u>	20
<u>Signatures</u>	21

Table of Contents

GOVERNMENT PROPERTIES TRUST, INC.
CONSOLIDATED BALANCE SHEETS
(in thousands, except share amounts)

	June 30, 2006 (unaudited)	December 31, 2005
ASSETS		
Real estate at cost:		
Land	\$ 37,665	\$ 32,800
Buildings and improvements	326,311	280,861
Tenant origination costs	78,513	60,405
Real estate under development	773	16,577
Furniture and equipment	475	456
	443,737	391,099
Accumulated depreciation	(20,956)	(13,295)
	422,781	377,804
Cash and cash equivalents	5,227	4,857
Restricted cash escrows	7,303	16,887
Tenant receivables	8,954	6,873
Notes receivable from tenant	569	603
Deferred costs, net	3,956	4,020
Real estate deposits		450
Other assets	4,504	1,583
Total assets	\$ 453,294	\$ 413,077
LIABILITIES AND STOCKHOLDERS EQUITY		
Liabilities:		
Accounts payable and accrued expenses	\$ 7,881	\$ 8,420
Dividends payable	2,336	3,110
Lines of credit	35,080	17,500
Mortgage notes payable	252,480	225,033
Total liabilities	297,777	254,063
Stockholders' equity:		
Common stock (\$0.01 par value; 50,000,000 shares authorized, 20,763,136 and 20,721,612 shares issued and outstanding at June 30, 2006 and December 31, 2005, respectively)	206	206
Additional paid-in capital	189,733	189,123
Accumulated deficit	(37,896)	(30,916)
Accumulated other comprehensive income	3,474	601
Total stockholders' equity	155,517	159,014
Total liabilities and stockholders' equity	\$ 453,294	\$ 413,077

See accompanying notes.

3

Table of Contents

GOVERNMENT PROPERTIES TRUST, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME
(unaudited and in thousands, except per share amounts)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2006	2005	2006	2005
Revenue				
Rental income	\$ 11,031	\$ 6,141	\$ 20,831	\$ 10,465
Tenant reimbursements	609	132	1,175	312
Total revenue	11,640	6,273	22,006	10,777
Expenses				
Property operations	1,892	1,123	3,703	1,978
Real estate taxes	1,012	569	1,938	1,025
Depreciation and amortization	4,020	2,342	7,661	3,665
General and administrative	1,330	1,201	2,639	2,341
Total expenses	8,254	5,235	15,941	9,009
Operating income	3,386	1,038	6,065	1,768
Other income (expense)				
Interest income	111	441	233	1,099
Interest expense	(3,996)	(2,133)	(7,399)	(3,471)
Amortization of deferred financing fees	(225)	(58)	(428)	(168)
Net loss	\$ (724)	\$ (712)	\$ (1,529)	\$ (772)
Earnings per share (basic and diluted)				
Net loss	\$ (0.04)	\$ (0.03)	\$ (0.07)	\$ (0.04)
Distributions declared per share	\$ 0.1125	\$ 0.15	\$ 0.2625	\$ 0.30
Weighted average shares outstanding (basic and diluted)	20,631	20,573	20,617	20,556
Net loss	\$ (724)	\$ (712)	\$ (1,529)	\$ (772)
Other comprehensive income (loss)				
Unrealized derivative gain (loss) on forward-starting interest rate swaps	1,212	(1,368)	2,873	(1,368)
Comprehensive income (loss)	\$ 488	\$ (2,080)	\$ 1,344	\$ (2,140)

See accompanying notes.

Table of Contents

GOVERNMENT PROPERTIES TRUST, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited and in thousands)

	Six Months Ended	
	June 30,	
	2006	2005
Operating activities		
Net loss	\$ (1,529)	\$ (772)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	7,661	3,665
Amortization of deferred financing fees	428	168
Amortization of premium on mortgage notes payable	(51)	
Compensation expense	365	362
Changes in assets and liabilities:		
Tenant receivables	(2,081)	(1,681)
Restricted cash escrows	414	(2,245)
Other assets	(47)	(698)
Accounts payable and accrued expenses	2,197	288
Net cash provided by (used in) operating activities	7,357	(913)
Investing activities		
Expenditures for real estate	(36,849)	(131,098)
Deposits on future real estate purchases		(2,829)
Development of real estate assets	(8,937)	(2,571)
Restricted cash escrows	9,170	(15,284)
Note receivable from tenant	34	31
Expenditures for furniture and equipment	(19)	
Net cash used in investing activities	(36,601)	(151,751)
Financing activities		
Financing fees	(364)	(1,457)
Net borrowings under lines of credit	17,580	
Proceeds from mortgage notes payable	19,950	91,732
Principal payments on mortgage notes payable	(1,328)	(689)
Dividends paid	(6,224)	(6,213)
Net cash provided by financing activities	29,614	83,373
Net increase (decrease) in cash and cash equivalents	370	(69,291)
Cash and cash equivalents, beginning of period	4,857	93,815
Cash and cash equivalents, end of period	\$ 5,227	\$ 24,524
Non-Cash Investing Activity		
Accounts payable and accrued expenses included in real estate, net	\$ 2,492	\$

Non-Cash Financing Activity

Assumption of mortgage note payable included in real estate, net	\$ 8,876	\$ 15,753
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See accompanying notes.

5

Table of Contents

GOVERNMENT PROPERTIES TRUST, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of Government Properties Trust, Inc., a Maryland corporation (the Company), have been prepared pursuant to Securities and Exchange Commission (SEC) rules and regulations and should be read in conjunction with the consolidated financial statements and notes thereto included in the 2005 Form 10-K. The accompanying condensed consolidated financial statements highlight significant changes to the Notes included in the 2005 Form 10-K and present interim disclosures as required by the SEC. The accompanying condensed consolidated financial statements reflect, in the opinion of management, all adjustments considered necessary for a fair presentation of the interim financial statements. All such adjustments are of a normal and recurring nature.

The preparation of the condensed consolidated financial statements in conformity with U.S. generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expense during the reporting periods. Our results for the three months and six months ended June 30, 2006 are not necessarily indicative of our results for any future interim period or for the full fiscal year.

2. Nature of Business and Operations

The Company began formal operations with its first property acquisition in December 2002 and, as of June 30, 2006, the Company owned 21 properties located throughout the United States. The Company acquires properties through various operating entities, which are wholly owned by the Company. The Company has elected to be taxed as a real estate investment trust (REIT) under the Internal Revenue Code of 1986, as amended. The Company operates in one segment.

3. Common Stock and Earnings Per Share

The Company reports earnings per share pursuant to Statement of Financial Accounting Standards No. 128, Earnings Per Share. Basic and diluted loss per share attributable for all periods presented is computed by dividing the loss to common stockholders by the weighted average number of common shares and potential common stock outstanding during the period. The Company had nonvested stock grants of 131,769 and 148,963 shares outstanding during the three months ended June 30, 2006 and 2005, respectively and 134,773 and 165,338 for the six months ended June 30, 2006 and 2005, respectively, which were not included in the computation of diluted earnings per share because the effect would have been anti-dilutive.

4. Deferred Costs

Deferred costs consist of the following (in thousands):

	June 30, 2006	December 31, 2005
Financing costs	\$ 5,020	\$ 4,656
Accumulated amortization	(1,064)	(636)
	\$ 3,956	\$ 4,020

5. Equity Incentive Plan

In December 2004, the FASB issued Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment* (FAS 123(R)), which replaced FAS 123. FAS 123(R) requires compensation cost related to share-based payment transactions to be recognized in the financial statements. We adopted FAS 123(R) effective January 1, 2006 using the modified-prospective method. Because we previously used a fair value based method of accounting for determining compensation expense associated with the issuance of all restricted shares granted, the adoption of this standard did not have a material effect on our results of operations and financial position. Had we

adopted FAS 123(R) in prior periods, the impact of that standard would have approximated the impact of FAS 123 as previously disclosed.

The Company has a 2003 Equity Incentive Compensation Plan (the Plan), which reserved 1,000,000 shares of Common Stock for issuance thereunder. In connection with the original issuance of shares during the first quarter of 2004, the Company adopted the fair value recognition provisions of SFAS No. 123, Accounting for Stock Based Compensation and

Table of Contents

SFAS No. 148, Accounting for Stock Based Compensation Transition and Disclosure an amendment of FASB Statement No. 123 .

The Company recognizes compensation expense for restricted shares issued based upon the fair market value of the common stock at the grant date. Compensation expense is recognized on a straight-line basis over the service period which is typically the vesting period and is included in general and administrative expense in the accompanying consolidated statement of operations. The Company began issuing restricted shares in 2004. The Company granted 190,045 restricted shares during 2004, 26,198 restricted shares during 2005 and 41,524 restricted shares during the six months ended June 30, 2006 to members of the Board of Directors, employees and consultants. During 2005 there were 184 restricted shares forfeited. The Company recorded compensation expense related to the restricted stock grants of \$186,000 and \$181,000 for the three months ended June 30, 2006 and 2005, respectively, and \$365,000 and \$362,000 for the six months ended June 30, 2006 and 2005, respectively. As of June 30, 2006, there are 742,417 shares available for grant under the Plan.

6. Mortgage Notes Payable and Line-of-Credit

Mortgage notes payable and lines-of-credit consisted of the following (in thousands):

	June 30, 2006	December 31, 2005
Mortgage Notes Payable(A),(B),(C)		
Mortgage notes payable to various financial institutions, collateralized by various properties, interest at fixed rates ranging from 5.09% to 8.23% per annum, with principal and interest payable monthly through 2026. The weighted average interest rate at June 30, 2006 and December 31, 2005 was 5.83% and 5.80%, respectively.	\$ 251,099	\$ 223,601
Lines of Credit		
Line-of-credit with a financial institution for property acquisitions (maximum borrowing level of \$65 million and available through November 20, 2008). The weighted average interest rate at June 30, 2006 and December 31, 2005 was equal to 6.84% and 5.57%, respectively. Advances are collateralized by various properties.(D)	\$ 35,080	\$ 17,500
Line-of-credit with a financial institution for property acquisitions (maximum borrowing level of \$10 million and available through April 2007). Advances are uncollateralized.(E)	\$	\$

(A) The mortgages notes payable are subject to various operating covenants. In addition, the Company must periodically fund and maintain escrow accounts, to

make future real estate taxes, repairs and maintenance and insurance payments, as well as to fund certain tenant releasing costs. These are included in restricted cash escrows.

(B) Certain of the Company's real estate assets have been pledged as collateral for its mortgages notes payable. The amount of gross assets that have been encumbered is \$360.5 million and \$309.0 million at June 30, 2006 and December 31, 2005, respectively.

(C) Amounts exclude a premium of \$1.4 million at June 30, 2006 and December 31, 2005 related to the above market interest rate on a mortgage assumed.

(D) This line-of-credit

facility was obtained in November 2005 and bears an interest rate equal to either (a) a base rate determined by the higher of the prime rate or the federal funds rate plus 1/2 of 1%, or (b) an applicable margin, based upon the Company's total indebtedness to total asset value, plus LIBOR. At June 30, 2006 and December 31, 2005, the margin was LIBOR plus 1.40% and LIBOR plus 1.20%, respectively. Payments are interest only through the term and are payable at least quarterly. The line-of-credit facility contains certain covenants including maintenance of leverage, minimum fixed charge coverage ratios, minimum tangible net worth and limitations on certain indebtedness, guarantees and

cash dividends.
Advances under
the line-of-credit
totaled
\$17.58 million
for the six
months ended
June 30, 2006
and \$17.5
million during
the year ended
December 31,
2005. The
line-of-credit
facility is
guaranteed by
the Company.
The amount of
gross assets that
have been
encumbered is
\$81.9 million at
June 30, 2006
and
\$81.5 million at
December 31,
2005. In
April 2006, the
maximum
borrowing level
of the
line-of-credit
was increased
from
\$50 million to
\$65 million.

- (E) This
line-of-credit
facility was
obtained in
April 2006 and
is subject to the
covenants
described above
in Item (D).
Borrowings
under this
facility bear an
interest rate
equal to an

applicable
margin, based
upon our total
indebtedness to
total asset value,
plus

7

Table of Contents

the three month
LIBOR rate.
Any borrowings
on the credit
facility would
be priced at
LIBOR plus
2.40% as of
June 30, 2006.
Payments are
interest only
through the term
of the credit
facility and are
payable
monthly.

Total interest paid on the mortgage notes payable and lines-of-credit was \$3.9 million and \$2.2 million for the three months ended June 30, 2006 and 2005, respectively, and \$7.4 million and \$3.2 million for the six months ended June 30, 2006 and 2005, respectively.

7. Derivative Instruments and Hedging Activities

Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS 133), as amended and interpreted, establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. As required by SFAS 133, the Company records all derivatives on the balance sheet at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative and the resulting designation. Derivatives used to hedge the exposure to changes in the fair value of an asset, liability, or firm commitment attributable to a particular risk, such as interest rate risk, are considered fair value hedges. Derivatives used to hedge the exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges.

For derivatives designated as cash flow hedges, the effective portion of changes in the fair value of the derivative is initially reported in other comprehensive income (outside of earnings) and subsequently reclassified to earnings when the hedged transaction affects earnings, and the ineffective portion of changes in the fair value of the derivative is recognized directly in earnings. The Company assesses the effectiveness of each hedging relationship by comparing the changes in fair value or cash flows of the derivative hedging instrument with the changes in fair value or cash flows of the designated hedged item or transaction. For derivatives not designated as hedges, changes in fair value are recognized in earnings.

The Company's objective in using derivatives is to add stability to interest expense and to manage its exposure to interest rate movements or other identified risks. To accomplish this objective, the Company primarily uses interest rate swaps as part of its cash flow hedging strategy. Interest rate swaps designated as cash flow hedges involve the receipt of variable-rate amounts in exchange for fixed-rate payments over the life of the agreements without exchange of the underlying principal amount. In the second quarter of 2005, the Company entered into two forward-starting interest rate swap contracts with an aggregate notional amount of \$50 million to fix a portion of the interest rate associated with the anticipated issuance of future financings that are expected to occur in the fourth quarter of 2006. Accordingly, the maximum future period of time over which the Company is currently hedging its exposure to variability in future cash flows for forecasted transactions is approximately four months.

As of June 30, 2006, no derivatives were designated as fair value hedges or hedges of net investments in foreign operations. Additionally, the Company does not use derivatives for trading or speculative purposes. At June 30, 2006, derivatives with a fair value of \$3.5 million were included in other assets. The amounts reported in accumulated other comprehensive income relate to the derivatives described above. Upon the expected settlement of the derivatives in the fourth quarter of 2006, the amount paid or received will be amortized to interest expense over the term of the

Company's hedged debt.

8. Related Party Transactions

Genesis, the sponsor of the initial public offering by the predecessor company Gen-Net Lease Income Trust, Inc., paid the Company \$310,000 in June 2006 for previous offering costs pursuant to a conditional agreement between Genesis and the Company.

9. Property Acquisitions

The Company acquired the following properties during the six months ended June 30, 2006 and during the year ended December 31, 2005. The results of their operations are included in the Company's consolidated statements of operations from their respective dates of acquisition.

Table of Contents

Property	Location	Acquisition Cost (in thousands)	Month Acquired
2005 acquisitions(A):			
1201 Lloyd Boulevard (Portland Property)	Portland, OR	\$ 50,653	March
Niagara Center (Buffalo Niagara Center Property)	Buffalo, NY	71,673	May
Social Security Administration (Buffalo SSA Property)	Buffalo, NY	5,435	May
Drug Enforcement Administration (Sterling DEA Property)(B)	Sterling, VA Martinsburg, WV	21,070	June July
Internal Revenue Service (Martinsburg IRS Property)(C)	Dallas, TX	30,643	September
Social Security Administration (Dallas SSA Property)	Vicksburg, MS	9,583	November
Army Corps of Engineers (Vicksburg MS Property)		26,850	
		\$ 215,907	
2006 acquisitions(A):			
Riverside County (Riverside Property)(D)	Riverside, CA	\$ 18,415	February
United States Citizenship and Immigration Service (Harlingen USCIS Property)	Harlingen, TX	27,330	May
		\$ 45,745	

(A) In accordance with SFAS 141, the Company allocated the purchase price for these properties to net tangible and identified intangible assets acquired based on their fair values (including land, buildings, tenant improvements, acquired above and below market leases and the origination cost

of acquired in-place leases) and acquired liabilities, and allocated the purchase price based on these assessments, including land at appraised value and buildings at replacement costs. The Company assessed fair value based on estimated cash flow projections that utilize discount and capitalization rates deemed appropriate by management and available market information. Such estimates are subject to refinement as additional valuation information is received. The value of tenant origination costs are amortized over the remaining term of the respective leases.

- (B) In connection with the purchase of this property, the Company assumed a first mortgage note in the amount of

\$15.8 million.

Also included in the acquisition cost is an amount of \$1.5 million related to the premium recognized on the above market interest rate on the assumed mortgage.

- (C) Under terms of the existing lease, the federal government has an option to purchase the Martinsburg IRS Property for approximately \$24.8 million. Real estate at cost, net of accumulated depreciation of the Martinsburg IRS Property, was \$29.7 million at June 30, 2006.

- (D) In connection with the purchase of this property, the Company assumed a first mortgage note in the amount of \$8.9 million.

10. Real Estate Development

In March 2006, the Company completed the expansion of the Bureau of Public Debt facility in Parkersburg, West Virginia by an additional 102,000 rentable square feet. The cost of the expansion to the Property is estimated to approximate \$22.2 million and has been allocated to buildings and improvements and tenant origination costs in the accompanying Consolidated Balance Sheet as the property was placed into operations on March 15, 2006. At June 30, 2006 and December 31, 2005, approximately \$1.6 million and \$4.1 million of costs capitalized, respectively, were included in accounts payable and accrued expenses in the accompanying Consolidated Balance Sheets. At June 30,

2006 the Company held \$2.7 million of restricted cash escrows to fund the accrued cost of the expansion.

11. Unaudited Pro Forma Condensed Consolidated Financial Information

The accompanying unaudited Pro Forma Condensed Consolidated Financial Information is presented as if, at January 1, 2005, the Company acquired the properties described in Note 9 Property Acquisitions and the shares outstanding at June 30, 2006 were also outstanding at January 1, 2005. The properties listed as follows began operations during 2005 and therefore their historical results of operations are included in the Pro Forma Condensed Consolidated Financial Information from the date indicated. In management's opinion, all adjustments necessary to reflect the effects of the above transactions have been made.

	Date Property Began Operation
Buffalo SSA Property	June 2005
Dallas SSA Property	August 2005

Table of Contents

The unaudited Pro Forma Condensed Consolidated Financial Information is not necessarily indicative of what the actual results of operations would have been assuming the above mentioned transactions had occurred at the dates indicated above, nor does it purport to represent our future results of operations.

Pro Forma Condensed Consolidated Financial Information

(Unaudited and in thousands, except per share amounts)

	Six Months Ended June 30,	
	2006	2005
Total revenue	\$ 23,423	\$ 19,328
Net loss	\$ (1,443)	\$ (1,708)
Loss per diluted common share	\$ (0.07)	\$ (0.08)

Table of Contents

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This report contains forward-looking statements. These forward-looking statements include estimates regarding:

our estimated general and administrative expense;

our risk mitigation strategy;

our policy to reserve for operating expenses and capital costs;

our distribution policy;

our operating expenses;

our adequacy of our available capital for future capital requirements;

our capital expenditures; and

the impact of changes in interest rates.

Forward-looking statements can be identified by the use of words such as may, will, should, expects, plans, anticipates, believes, estimates, predicts, intends, continue, or the negative of such terms, or other comparable terminology. Forward-looking statements also include the assumptions underlying or relating to any of the foregoing statements. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including the risks discussed in Risk Factors and elsewhere in this report.

In addition, we discussed a number of material risks in our annual report on Form 10-K for the year ended December 31, 2005. Those risks continue to be relevant to our performance and financial condition. Moreover, we operate in a very competitive and rapidly changing environment. New risk factors emerge from time to time and it is not possible for management to predict all such risk factors, nor can it assess the impact of all such risk factors on our company's business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements. Given these risks and uncertainties, investors should not place undue reliance on forward-looking statements as a prediction of actual results.

All forward-looking statements included in this report are based on information available to us on the date hereof. We assume no obligation to update any forward-looking statements.

The following is a discussion of our interim results of operations, financial condition and liquidity and capital resources for the three and six months ended June 30, 2006 compared to the corresponding periods in 2005. It should be read in conjunction with the Consolidated Financial Statements and Notes thereto included herein and the 2005 Form 10-K.

OVERVIEW

We primarily invest in single tenant properties under long-term leases to the U.S. government, state governments, local governments, and government-sponsored enterprises. We are a self-managed, self-administered company that has elected to be taxed as a real estate investment trust, or REIT, under the federal tax laws. We believe that we are the only public company solely focused on investing in government-leased properties. We own each of our properties through separate, wholly owned entities. Our business consists of buying and managing recently built or renovated office properties primarily leased to the federal government, acting through the General Services Administration (GSA), under long-term leases. At June 30, 2006, we owned 21 primarily GSA-leased properties. These properties are 98% occupied.

CRITICAL ACCOUNTING POLICIES

Refer to our 2005 Annual Report on Form 10-K for a discussion of our critical accounting policies, which include our revenue recognition of related lease agreements, recording of real estate at depreciated cost, allocation of the purchase price of properties we

Table of Contents

acquire to net tangible and identified intangible assets and derivative instruments. During the first six months of 2006, there were no material changes to our critical accounting policies.

RESULTS OF OPERATIONS**Comparison of three months ended June 30, 2006 to June 30, 2005**

Our results of operations for the three months ended June 30, 2006 compared to the same period in 2005 were significantly affected by our acquisitions in both years. As a result, our results are not comparable from period to period. Therefore, in the table below, we have also separately presented the results of our Same Properties Portfolio. Our Same Properties Portfolio includes the results of twelve properties consisting of approximately 730,000 rentable square feet that were owned for the entire period presented in both years. Our Total Portfolio also includes the operating results of the properties we acquired during 2005 and 2006. These nine properties, referred to as Acquired Properties, consist of approximately 1,171,000 rentable square feet and are collectively referred to as the Acquired Properties.

(in thousands)	Same Properties Portfolio			Acquired Properties		General & Administrative		Total Portfolio		
	2006	2005	Change	2006	2005	2006	2005	2006	2005	Change
Revenue:										
Rental income	\$ 4,966	\$ 4,312	\$ 654	\$ 6,065	\$ 1,829	\$	\$	\$ 11,031	\$ 6,141	\$ 4,890
Tenant reimbursements and other	213	4	209	396	128			609	132	477
Total revenue	5,179	4,316	863	6,461	1,957			11,640	6,273	5,367
Expenses:										
Property operations	679	689	(10)	1,213	434			1,892	1,123	769
Real estate taxes	589	458	131	423	111			1,012	569	443
Depreciation and amortization	1,516	1,297	219	2,486	1,037	18	8	4,020	2,342	1,678
General and administrative						1,330	1,201	1,330	1,201	129
Total expenses	2,784	2,444	340	4,122	1,582	1,348	1,209	8,254	5,235	3,019
Operating income(loss)	2,395	1,872	523	2,339	375	(1,348)	(1,209)	3,386	1,038	2,348
Interest income	60	83	(23)	11	15	40	343	111	441	(330)
Interest expense	(1,860)	(1,736)	(124)	(1,643)	(397)	(493)		(3,996)	(2,133)	(1,863)
Amortization of deferred financing fees	(54)	(54)		(16)	(4)	(155)		(225)	(58)	(167)
Net income (loss)	\$ 541	\$ 165	\$ 376	\$ 691	\$ (11)	\$(1,956)	\$(866)	\$(724)	\$(712)	\$(12)

Total portfolio rental income revenue increased to \$11.0 million in 2006 from \$6.1 million in 2005, an increase of \$4.9 million. The increase was primarily due to our Acquired Properties. Rental revenue for our Same Properties Portfolio increased \$654,000, or 15.2% from the prior period amount. This increase is due to the annual CPI-measured inflation adjustment in the portion of rent attributable to operating costs and additional revenue of approximately

\$600,000 for our Parkersburg expansion placed into service on March 15, 2006.

Total portfolio tenant reimbursements and other revenue increased to \$609,000 in 2006 from \$132,000 for 2005, an increase of \$477,000. This amount represents the tenants' reimbursements for real estate tax expense in excess of the real estate tax base amount as defined in their respective lease agreements and other income (primarily parking) earned on the properties. Of the increased amount, \$268,000 was due to our Acquired Properties. The remaining increase of \$209,000 is for higher real estate tax expense in excess of the real estate tax base amount for our Same Properties Portfolio.

Total portfolio property operations expense increased to \$1.9 million in 2006 from \$1.1 million in 2005, an increase of \$769,000. The increase was primarily due to our Acquired Properties which increased by \$779,000 million over the prior year amount.

Total portfolio real estate tax expense increased to \$1.0 million in 2006 from \$569,000 in 2005, an increase of \$443,000. The increase was primarily due to our Acquired Properties which increased \$313,000 over the prior year amount. Real estate tax expense for our Same Properties Portfolio increased \$131,000, or 28.6% from the prior period amount. This increase was due to increased real estate

Table of Contents

taxes paid in 2006 as compared to 2005 due to higher real estate valuations for certain of these properties which are reflective of our acquisition cost for the property.

Total portfolio depreciation and amortization expense increased to \$4.0 million in 2006 from \$2.3 million in 2005. The increase was primarily due to our Acquired Properties. Depreciation and amortization expense for our Same Properties Portfolio increased \$219,000, or 16.9% from the prior period amount due to the additional expense from the Parkersburg expansion.

General and administrative expense increased to \$1.3 million in 2006 from \$1.2 million in 2005. The increase was primarily due to an increase in personnel costs related to our operations and acquisition activities.

Interest income was \$111,000 for 2006 and \$441,000 for 2005. The decrease was due to a decrease in cash and cash equivalents held during the first quarter of 2006 as compared to 2005.

Interest expense was \$4.0 million for 2006 and \$2.1 million for 2005. The increase was due primarily to interest costs associated with debt placed on our properties and from borrowings on our line-of-credit facility. We have increased our secured fixed rate mortgage debt from \$77.6 million at the beginning of 2005 to \$251.1 million at June 30, 2006.

Also, we have drawn on our line-of-credit beginning in November 2005 and have an outstanding balance of \$35.1 million at June 30, 2006. Our weighted-average interest rate on our fixed rate mortgages was 5.83% and 5.90% as of June 30, 2006 and 2005, respectively. Our interest rate on our line-of-credit facility was 6.84% at June 30, 2006. Amortization of deferred financing fees was \$225,000 in 2006 and \$58,000 in 2005. The increase was due to the amortization of financing fees related to our revolving line-of-credit agreement acquired in the fourth quarter of 2005, from fixed rate debt placed on our acquired properties, and from fixed rate debt placed on certain properties of our Same Properties Portfolio during the second quarter of 2005.

Comparison of six months ended June 30, 2006 to June 30, 2005

Our results of operations for the six months ended June 30, 2006 compared to the same period in 2005 are as follows:

(in thousands)	Same Properties Portfolio			Acquired Properties		General & Administrative		Total Portfolio		
	2006	2005	Change	2006	2005	2006	2005	2006	2005	Change
Revenue:										
Rental income	\$ 9,420	\$ 8,621	\$ 799	\$ 11,411	\$ 1,844	\$	\$	\$ 20,831	\$ 10,465	\$ 10,366
Tenant reimbursements and other	405	184	221	770	128			1,175	312	863
Total revenue	9,825	8,805	1,020	12,181	1,972			22,006	10,777	11,229
Expenses:										
Property operations	1,357	1,536	(179)	2,346	442			3,703	1,978	1,725
Real estate taxes	1,177	909	268	761	116			1,938	1,025	913
Depreciation and amortization	2,858	2,594	264	4,766	1,056	37	15	7,661	3,665	3,996
General and administrative						2,639	2,341	2,639	2,341	298
Total expenses	5,392	5,039	353	7,873	1,614	2,676	2,356	15,941	9,009	6,932
Operating income(loss)	4,433	3,766	667	4,308	358	(2,676)	(2,356)	6,065	1,768	4,297
Interest income	156	112	44	27	15	50	972	233	1,099	(866)
Interest expense	(3,540)	(3,074)	(466)	(3,056)	(397)	(803)		(7,399)	(3,471)	(3,928)
Amortization of deferred	(108)	(93)	(15)	(31)	(4)	(289)	(71)	(428)	(168)	(260)

financing fees

Net income

(loss)	\$ 941	\$ 711	\$ 230	\$ 1,248	\$ (28)	\$ (3,718)	\$ (1,455)	\$ (1,529)	\$ (772)	\$ (757)
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Total portfolio rental income revenue increased to \$20.8 million in 2006 from \$10.5 million in 2005, an increase of \$10.3 million. The increase was primarily due to our Acquired Properties. Rental revenue for our Same Properties Portfolio increased \$799,000, or 9.3% from the prior period amount. This increase is due to the annual CPI-measured inflation adjustment in the portion of rent attributable to operating costs and additional revenue of approximately \$720,000 for our Parkersburg expansion placed into service on March 15, 2006.

Table of Contents

Total portfolio tenant reimbursements and other revenue increased to \$1.2 in 2006 from \$312,000 for 2005, an increase of \$863,000. This amount represents the tenants' reimbursements for real estate tax expense in excess of the real estate tax base amount as defined in their respective lease agreements and other income (primarily parking) earned on the properties. Of the increased amount, \$642,000 was due to our Acquired Properties. The remaining increase of \$221,000 is for higher real estate tax expense in excess of the real estate tax base amount for our Same Properties Portfolio.

Total portfolio property operations expense increased to \$3.7 million in 2006 from \$2.0 million in 2005, an increase of \$1.7 million. The increase was primarily due to our Acquired Properties which increased by \$1.9 million over the prior year amount. Property operations expense for our Same Properties Portfolio decreased \$179,000, or 11.7% from the prior period amount. This decrease was due to a decrease in utilities at our College Park FDA property in the amount of \$140,000 as the government assumed the responsibility of paying for utilities on this property beginning at the end of the first quarter of 2005. The remaining decrease is primarily due to decreased franchise taxes for certain of our properties.

Total portfolio real estate tax expense increased to \$1.9 million in 2006 from \$1.0 million in 2005, an increase of \$913,000. The increase was primarily due to our Acquired Properties which increased \$645,000 over the prior year amount. Real estate tax expense for our Same Properties Portfolio increased \$268,000, or 29.5% from the prior period amount. This increase was due to increased real estate taxes paid in 2006 as compared to 2005 due to higher real estate valuations for certain of these properties which are reflective of our acquisition cost for the property.

Total portfolio depreciation and amortization expense increased to \$7.7 million in 2006 from \$3.7 million in 2005. The increase was primarily due to our Acquired Properties. Depreciation and amortization expense for our Same Properties Portfolio increased \$264,000, or 10.2% from the prior period amount due to the additional expense from the Parkersburg expansion.

General and administrative expense was \$2.6 million for 2006 and \$2.3 million for 2005. The increase was primarily due to an increase in personnel costs related to our operations and acquisition activities.

Interest income was \$233,000 for 2006 and \$1.1 million for 2005. The decrease was due to a decrease in cash and cash equivalents held during the first half of 2006 as compared to the first half of 2005.

Interest expense was \$7.4 million for 2006 and \$3.5 million for 2005. The increase was due primarily to the interest costs associated with debt placed on our properties and from borrowings on our line-of-credit facility. We have increased our secured fixed rate mortgage debt from \$77.6 million at the beginning of 2005 to \$251.1 million at June 30, 2006. Also, we have drawn on our line-of-credit beginning in November 2005 and have an outstanding balance of \$35.1 million at June 30, 2006. Our weighted-average interest rate on our fixed rate mortgages was 5.83% and 5.90% as of June 30, 2006 and 2005, respectively. Our interest rate on our line-of-credit facility was 6.84% at June 30, 2006.

Amortization of deferred financing fees was \$428,000 in 2006 and \$168,000 in 2005. The increase was due to the amortization of financing fees related to our revolving line-of-credit agreement acquired in the fourth quarter of 2005, from fixed rate debt placed on our acquired properties, and from fixed rate debt placed on certain properties of our Same Properties Portfolio during the first half of 2005.

LIQUIDITY AND CAPITAL RESOURCES

Our short-term liquidity requirements consist primarily of funds to acquire properties and to pay for operating expenses, dividends, and other expenditures directly associated with our properties, such as:

acquisition costs, deposits on properties and purchases of properties;

recurring maintenance, repairs and other operating expenses necessary to maintain our properties;

property taxes, state and local tax assessments, and insurance expenses;

interest expense and scheduled principal payments on outstanding indebtedness;

capital expenditures incurred to facilitate the leasing of space at our properties, including tenant improvements and leasing commissions; and

Table of Contents

general and administrative expenses.

Historically, we have satisfied our short-term liquidity requirements through our existing working capital, cash provided from borrowings and cash provided by operations.

Our current mortgage debt obligations are set forth below:

Lender	Collateral	Balance as of June 30, 2006 (In Millions)
CW Capital	Bakersfield DEA property	\$ 1.4
CW Capital	Baton Rouge VA property	4.8
LaSalle Bank/GEMSA	Charleston SSA property	13.4
LaSalle Bank/GEMSA	Clarksburg GSA property	8.0
	Charleston Federal	
CW Capital	Courthouse property	14.4
Capital Realty	College Park FDA property	16.1
Key Bank	Dallas SSA property	6.2
CW Capital	Harlingen USCIS property	19.9
Bank of America	Kingsport SSA property	2.2
Wachovia Bank	Lenexa FDA property	7.8
PNC Bank	Martinsburg IRS property	19.6
Bank of New York	Parkersburg BPD property	31.6
PNC Bank	Pittsburgh FBI property	20.3
Nomura Credit	Pittsburgh USCIS property	7.8
Wachovia Bank	Portland property	39.1
Northwestern Mutual	Sterling DEA property	15.3
J.P. Morgan Chase	Riverside County property	8.8
Merrill Lynch	Vicksburg property	14.4
		251.1
Premium on mortgage debt (Sterling DEA property)		1.4
Total Mortgage Notes Payable		\$ 252.5

We financed the acquisition of our Bakersfield DEA property in February 2005 through a \$1.4 million loan from CW Capital, which matures on March 1, 2020. The unpaid principal balance of the note bears interest at a rate of 5.867% per annum. Monthly payments are amortized on a 30-year schedule, with a balloon payment due March 1, 2020.

We financed the acquisition of our Baton Rouge VA property in February 2005 through a \$4.8 million loan from CW Capital, which matures on March 1, 2020. The unpaid principal balance of the note bears interest at a rate of 5.867% per annum. Monthly payments are amortized on a 30-year schedule, with a balloon payment due March 1, 2020.

We financed the acquisition of our Charleston SSA property in April 2003 through a \$14 million loan from LaSalle Bank, which matures on May 1, 2013. The unpaid principal balance of the note bears interest at a rate of 5.74% per annum. Monthly payments are amortized on a 30-year schedule, with a balloon payment due May 1, 2013.

We financed the acquisition of our Clarksburg GSA property in April 2003 through an approximately \$8.3 million loan from LaSalle Bank, which matures on May 1, 2013. The unpaid principal balance of the note bears interest at a rate of 5.74% per annum. Monthly payments are amortized on a 30-year schedule, with a balloon payment due May 1, 2013.

We financed the acquisition of our Charleston Federal Courthouse property in February 2005 through a \$14.6 million loan from CW Capital, which matures on March 1, 2020. The unpaid principal balance of the note bears interest at a

rate of 5.867% per annum. Monthly payments are amortized on a 30-year schedule, with a balloon payment due March 1, 2020.

We financed the acquisition of our College Park FDA property in October 2004 through the assumption of the seller's loan of \$16.7 million loan from Capital Realty, which matures on October 26, 2026. The unpaid principal balance of the note bears interest at a rate of 6.75% per annum. Payments of principal and interest are made monthly through October 26, 2026.

Table of Contents

We financed the acquisition of our Dallas SSA property in September 2005 through an approximately \$6.25 million loan from Key Bank, which matures on October 1, 2015. The unpaid principal balance of the note bears interest at a rate of 5.09% per annum. Monthly payments are amortized on a 30-year schedule, with a balloon payment due October 1, 2015.

We financed the acquisition of our Harlingen USCIS property in May 2006 through an approximately \$19.9 million loan from CW Capital, which matures on June 1, 2016. The unpaid principal balance of the note bears interest at a rate of 6.266% per annum. Monthly payments are amortized on a 30-year schedule, with a balloon payment due June 1, 2016.

We financed the acquisition of our Kingsport SSA property in April 2003 through the assumption of the seller's first mortgage loan in the amount of \$2.3 million from Bank of America, which matures on April 1, 2010, and an unsecured loan issued by the seller in the amount of \$0.2 million which we repaid in July 2004. The unpaid principal balance of the first mortgage loan bears interest at a rate of 8.23% per annum, with monthly payments being amortized on a 25-year schedule and has a balloon payment due April 1, 2010.

We obtained financing related to the acquisition of our Lenexa FDA property in July 2004 through an \$8.0 million loan from Wachovia Bank, which matures on August 11, 2009. The unpaid principal balance of the note bears interest at a rate of 5.44% per annum. Monthly payments are amortized on a 27-year schedule, with a balloon payment due August 11, 2009.

We financed the acquisition of our Martinsburg IRS property in July 2005 through an approximately \$19.6 million loan from PNC Bank, which matures on August 1, 2015. The unpaid principal balance of the note bears interest at a rate of 5.24% per annum. Accrued interest only payments are due monthly through August 2006. Thereafter, monthly payments are amortized on a 30-year schedule, with a balloon payment due August 1, 2015.

We obtained financing related to the acquisition of our Parkersburg BPD property in March 2005 through a combined \$31.8 million loan from the Bank of New York, which matures on March 15, 2021. The loan is comprised of two notes totaling \$26.8 million and \$5.0 million, respectively. The unpaid principal balance of the \$26.8 million note bears interest at a rate of 5.40% per annum. Monthly payments were interest only through the date of completion of the Parkersburg expansion on March 15, 2006. Thereafter monthly payments are amortized on a 25-year schedule, with a balloon payment due March 15, 2021. The \$5.0 million note bears interest at 5.75% with interest payments due monthly and principal due March 15, 2021.

We obtained financing related to the acquisition of our Pittsburgh FBI property in July 2004 through a \$21.0 million loan from PNC Bank, which matures on August 1, 2009. The unpaid principal balance of the note bears interest at a rate of 5.5% per annum. Monthly payments are amortized on a 26-year schedule, with a balloon payment due August 1, 2009.

We obtained financing related to the acquisition of our Pittsburgh USCIS property in December 2004 through an \$8.0 million loan from Nomura Credit, which matures on December 11, 2011. The unpaid principal balance of the note bears interest at a rate of 5.13% per annum. Monthly payments are amortized on a 25-year schedule, with a balloon payment due December 11, 2011.

We obtained financing related to the acquisition of our Portland property in April 2005 through a \$39.1 million loan from Wachovia Bank, which matures on May 11, 2015. The unpaid principal balance of the note bears interest at a rate of 5.49% per annum. Accrued interest only payments are due monthly through November 11, 2006. From December 11, 2006 through November 11, 2013, monthly payments are amortized on a 30-year schedule. From December 11, 2013 through April 11, 2015, monthly payments are amortized on a 25-year schedule, with a balloon payment due May 11, 2015.

We financed the acquisition of our Sterling DEA property in June 2005 through the assumption of the seller's loan of \$15.8 million loan from Northwestern Mutual, which matures on March 1, 2020. The unpaid principal balance of the note bears interest at a rate of 7.98% per annum. Monthly payments are amortized on a 20-year schedule, with a balloon payment due March 1, 2020. We recorded a premium of \$1,482,178 related to the above market interest rate on the assumed debt. Amortization of this premium will be included in interest expense on the consolidated statement of operations.

We financed the acquisition of our Riverside County property in February 2006 through the assumption of the seller's loan of \$8.9 million loan from J.P. Morgan Chase, which matures on December 1, 2014. The unpaid principal balance of the note bears interest at a rate of 5.79% per annum. Monthly payments are amortized on a 30-year schedule, with a balloon payment due December 1, 2014.

We financed the acquisition of our Vicksburg COE property in November 2005 through a \$14.4 million loan from Merrill Lynch Mortgage Company, which matures on August 1, 2016. The unpaid principal balance of the note bears interest at a rate of 5.62% per annum. Accrued interest only payments are due monthly.

Table of Contents

The mortgages on our properties contain customary restrictive covenants, including provisions that may limit the borrowing subsidiary's ability, without the prior consent of the lender, to incur additional indebtedness, further mortgage or transfer the applicable property, purchase or acquire additional property, discontinue insurance coverage, change the conduct of its business or make loans or advances to, enter into any transaction of merger or consolidation with, or acquire the business, assets or equity of, any third party.

In May 2005, the Company entered into two forward-starting interest rate swap contracts with an aggregate notional amount of \$50 million to fix a portion of the interest rate associated with the anticipated issuance of future financings that are expected to occur in the fourth quarter of 2006. The period of time over which the Company expects to hedge its continued exposure to variability in future cash flows for the forecasted transactions is approximately four months. We entered into a \$50 million revolving credit facility in November 2005 led by Wachovia Capital Markets, LLC. Wachovia Bank, N.A. serves as administrative agent. In April 2006, the maximum borrowing level of the credit facility was increased to \$65 million. This credit facility replaced the Company's prior \$50 million revolving credit agreement led by First National Bank of Omaha which also is participating in the new credit facility. The term of the credit facility is for three years and may be extended for one additional year. The amount available to be borrowed under the credit facility is based upon the combined value of certain collateral properties. The initial pool of collateral includes the Niagara Center, Buffalo SSA and Mineral Wells BPD properties. The credit facility will provide us funding for future acquisitions and facilitate additional capitalization.

Borrowings under the credit facility bear interest at a rate equal to either (a) a base rate determined by the higher of the Prime Rate or the Federal Funds Rate plus 1/2 of 1%, or (b) an applicable margin, based upon our total indebtedness to total asset value, plus LIBOR. The borrowings on the credit facility are currently priced at LIBOR plus 1.40%. Payments are interest only through the term of the credit facility and are payable at least quarterly.

The Wachovia credit facility is guaranteed by us and certain of our unencumbered subsidiaries which currently are our Mineral Wells BPD, Buffalo Niagara Center and Buffalo SSA properties. The credit facility contains financial covenants related to maintenance of leverage, fixed charge coverage ratios and tangible net worth and also contains affirmative and negative covenants including, among other things, limitations on certain indebtedness, guarantees of indebtedness, level of cash dividends and other transactions as defined in the agreement.

In April 2006, the Company obtained an additional line-of-credit facility through First National Bank of Omaha, N.A. with a maximum borrowing level of \$10 million and available through April 2007. The \$10 million line-of-credit facility is unsecured and is subject to the covenants described above as related to the revolving credit facility led by Wachovia Capital Markets, LLC. Borrowings under this facility bear an interest rate equal to an applicable margin, based upon our total indebtedness to total asset value, plus the three month LIBOR rate. Any borrowings on the credit facility would currently be priced at LIBOR plus 2.20%. Payments are interest only through the term of the credit facility and are payable monthly.

Our long-term liquidity requirements consist primarily of funds to pay for property acquisitions, scheduled debt maturities, renovations, expansions and other non-recurring capital expenditures that need to be made periodically to our properties, the costs associated with acquisitions of properties that we pursue and dividend payments to stockholders. Historically, we have satisfied our long-term liquidity requirements through various sources of capital, including our existing working capital, cash provided by operations, sales of equity securities, and long-term mortgage indebtedness. Certain of our fixed-rate mortgages require that fully-funded sinking fund reserves be established and maintained for future capital expenditures related to marketing, tenant improvements or leasing commissions. We periodically evaluate requirements for future capital expenditures on our properties not covered by mortgage reserve fund provisions. Our intention is and has been to have a funded reserve for such situations available at the time the capital expenditure is expected to be incurred.

We believe that our net cash provided by operating activities, draws under our revolving line of credit and proceeds from other financing sources that we expect to be available to us will provide sufficient liquidity to meet our cash needs during the next twelve months.

CASH DISTRIBUTION POLICY

We have elected to be treated as a REIT under the federal tax laws commencing as of our taxable year beginning January 1, 2003. To qualify as a REIT, we must, among other things, distribute at least 90% of our ordinary taxable

income to our stockholders. We intend to comply with these requirements and maintain our REIT status. As a REIT, we generally will not be subject to corporate federal

Table of Contents

income taxes on taxable income we distribute (in accordance with the federal tax laws and applicable regulations) to our stockholders. If we fail to qualify as a REIT in any taxable year, we will be subject to federal income taxes at regular corporate rates and may not be able to qualify as a REIT for four subsequent tax years. Even as a REIT, we may be subject to certain state and local taxes on our income and property and to federal income and excise taxes on our undistributed taxable income, i.e., taxable income not distributed in the amounts and in the time frames prescribed by the federal tax laws and applicable regulations thereunder.

We intend to pay to our stockholders, within the time periods prescribed by the federal tax laws (in our case by January 31 of the following year), all or substantially all of our annual taxable income, including gains from the sale of real estate and recognized gains on sale of securities. We will continue our policy of making sufficient cash distributions to stockholders for us maintain REIT status under the federal tax laws and to avoid corporate income and excise tax on undistributed income. All distributions are made at the discretion of our board of directors and depend on our earnings, our financial condition, maintenance of our REIT status and other factors that our board of directors may deem relevant from time to time.

INFLATION

Our GSA leases generally contain provisions designed to mitigate the adverse impact of inflation. These provisions increase rental rates during the terms of the leases by indexed escalations based on the Consumer Price Index. In addition, our GSA leases generally require the tenant to pay a share of increases in operating expenses and all increases in real estate taxes. This may reduce our exposure to increases in costs and operating expenses resulting from inflation. However, increases in property operating costs above the escalation amount would harm our cash flow and may harm our ability to pay dividends.

FUNDS FROM OPERATIONS

REIT analysts generally consider funds from operations or FFO an alternative measure of performance for an equity REIT. The National Association of Real Estate Investment Trusts, or NAREIT, defines funds from operations as net income, computed in accordance with accounting principles generally accepted in the United States (GAAP), excluding gains or losses from sales of properties, but including real estate related depreciation and amortization and after adjustments for unconsolidated partnerships and joint ventures. We believe that FFO is helpful to investors as one of several measures of the performance of an equity REIT. We further believe that by excluding the effect of depreciation, amortization and gains or losses from sales of real estate, all of which are based on historical costs, which may be of limited relevance in evaluating current performance, FFO can facilitate comparison of operating performance between periods and between other equity REITs. Investors should review FFO along with GAAP Net Income Available for Common Shares and cash flow from operating activities, investing activities and financing activities, when evaluating an equity REIT's operating performance. We compute FFO in accordance with standards established by NAREIT, which may not be comparable to FFO reported by other REITs that do not define the term in accordance with the current NAREIT definition or that interpret the current NAREIT definition differently than us. FFO does not represent cash generated from operating activities in accordance with GAAP, nor does it represent cash available to pay distributions and should not be considered as an alternative to net income, determined in accordance with GAAP, as an indication of our financial performance, or to cash flow from operating activities, determined in accordance with GAAP, as a measure of our liquidity, nor is it indicative of funds available to fund our cash needs, including our ability to make cash distributions.

The following table presents a reconciliation of GAAP to our funds from operations for the periods presented (in thousands, except per share amounts):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Net loss	\$ (724)	\$ (712)	\$ (1,529)	\$ (772)
Adjustments to reconcile to funds from operations:				

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Real estate depreciation and amortization (a)	4,001	2,334	7,624	3,650
Funds from operations	\$ 3,277	\$ 1,622	\$ 6,095	\$ 2,878
Funds from operations per common share	\$ 0.16	\$ 0.08	\$ 0.30	\$ 0.14

(a) Excludes depreciation of non-real estate assets of \$19,000 and \$8,000 for the three months ended June 30, 2006 and 2005, respectively, and \$37,000 and \$15,000 for the six months ended June 30, 2006 and 2005, respectively.

Table of Contents**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Our future income, cash flows and fair values relevant to financial instruments depend upon prevailing market interest rates. Market risk refers to the risk of loss from adverse changes in market prices and interest rates.

Market Risk Related to Fixed-Rate Debt

As of June 30, 2006, our debt included fixed-rate mortgage notes with a carrying value of \$251.1 million. Changes in market interest rates on our fixed-rate debt impacts the fair market value of the debt, but it has no impact on interest incurred or cash flow. The sensitivity analysis related to our fixed debt assumes an immediate 100 basis point move in interest rates from their actual June 30, 2006 levels, with all other variables held constant.

A 100 basis point increase in market interest rates would result in a decrease in the fair value of our fixed-rate debt by approximately \$16.0 million at June 30, 2006. A 100 basis point decrease in market interest rates would result in an increase in the fair market value of our fixed-rate debt by approximately \$16.5 million at June 30, 2006.

As of June 30, 2006, our derivatives, comprised of two forward starting interest rate swap contracts with a notional value of \$50 million, had a carrying value of \$3.5 million included in other assets. A 100 basis point increase in market interest rates would result in an asset of approximately \$6.9 million, a change of \$3.4 million in the fair market value of the derivatives at June 30, 2006. A 100 basis point decrease in market interest rates would result in an accounts payable and accrued liability of approximately \$300,000, a change of \$3.8 million in the fair market value of the derivatives at June 30, 2006.

INTEREST RATE SENSITIVITY

The following table provides information about our financial instruments that are subject to interest rate sensitivity. The table presents our mortgage notes payable by expected maturity date and weighted average interest rate as of June 30, 2006.

INTEREST RATE SENSITIVITY
(in thousands)

	2007	2008	2009	2010	2011	THEREAFTER	TOTAL
MORTGAGE NOTES PAYABLE:							
Fixed rate amount	\$3,915	\$4,400	\$4,697	\$30,736	\$4,624	\$ 202,727	\$251,099
Weighted-average interest rate	6.01%	5.98%	5.99%	5.57%	6.08%	5.86%	5.83%

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of disclosure controls and procedures. Our management continues to review our internal controls and procedures and the effectiveness of those controls. As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our CEO and CFO, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-15(e) of the Securities Exchange Act of 1934. Based upon that evaluation, our CEO and CFO concluded that our disclosure controls and procedures are effective in timely alerting them to material information relating to us (including our consolidated subsidiaries) required to be included in our periodic SEC filings.

Changes in internal control over financial reporting. There have been no significant changes in the Company's internal controls or in other factors that could significantly affect internal controls during the quarter ended June 30, 2006.

Table of Contents**PART II OTHER INFORMATION****ITEM 1A. RISK FACTORS**

Please refer to our 2005 annual report or Form 10-K for a detailed discussion of risk factors under Part I, Item 1A. Set forth below are certain risks affected by information we received in the first half of 2006.

We acquired eight properties for an amount of \$123.2 million in 2004, seven properties for an amount of \$215.9 million in 2005 and two properties for an amount of \$45.7 million in the first six months of 2006. Net income from the properties we own has been less than the dividends we have paid to date. We may not be able to generate sufficient cash to pay dividends in the future.

Rent from the U.S. government and other governmental agencies represented approximately 97% of our revenues for the six months of 2006 and 96% for the year ended December 31, 2005. In addition, the U.S. government and other governmental agencies leased 96% of our total leased square feet of property as of June 30, 2006. Any default by the U.S. government, or its failure to renew its leases with us upon their expiration, could cause interruptions in the receipt of lease revenue or result in vacancies, or both, which would reduce our revenue until the affected property is leased, and could decrease the ultimate value of the affected property upon sale. Further, failure on the part of a tenant to comply with the terms of a lease may cause us to find another tenant. We cannot assure you that we would be able to find another tenant or find one without incurring substantial costs, or that if another tenant were found we would be able to enter into a new lease on favorable terms to us.

We have had historical losses of \$1.5 million for the six months ended June 30, 2006 and \$2.4 million for the year ended December 31, 2005. As of June 30, 2006, we had an accumulated deficit of \$37.8 million, of which \$7.0 million was due to accumulated losses and \$30.8 million was due to the payment of cash dividends. We cannot assure you that we will not have similar losses in the future.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

The Company's Annual Meeting of Shareholders was held on June 1, 2006. The matters voted upon at such meeting and the number of shares cast for, against or withheld, and abstained are as follows:

1. Election of directors to hold office until the next Annual Meeting of Shareholders:

NOMINEE	FOR	WITHHELD
Jerry D. Bringard	13,038,611	5,375,443
Robert M. Ames	13,234,494	5,179,560
Philip S. Cottone	13,177,442	5,236,612
Robert A. Peck	13,234,594	5,179,460
Thomas D. Peschio	13,226,961	5,187,093
Richard H. Schwachter	13,166,742	5,247,629

There are no directors other than those listed above whose term of office continued after the Annual Meeting.

2. Proposal to ratify the appointment of Ernst & Young LLP as the Company's independent auditors for 2006:

For: 15,151,703	Against: 174,574	Abstain: 498,547	Broker Non-Vote: -0-
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ITEM 6. EXHIBITS

12.1 Ratio of Fixed Charges

31.1 Certification of Chief Executive Officer pursuant to SEC Rule 13a-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

31.2 Certification of Chief Financial Officer pursuant to SEC Rule 13a-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

20

Table of Contents

SIGNATURE

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.

Date: August 9, 2006

GOVERNMENT PROPERTIES TRUST,
INC.

By: /s/ NANCY D. OLSON

Nancy D. Olson
Chief Financial Officer and Treasurer
(principal financial officer)