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

# FORM 10-Q

[X] Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended September 30, 1998

or

[ ] Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from _______ to _______

Commission File Number 1-10709

# PS BUSINESS PARKS, INC.

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| California | 95-4300881 |
| (State or Other Jurisdiction of Incorporation) | I.R.S. Employer Identification Number) |

701 Western Avenue, Glendale, California 91201-2397
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (818) 244-8080

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes X No

Number of shares outstanding of each of the issuer's classes of common stock, as of November 16, 1998: Common Stock, $0.01 par value, 23,635,650 shares outstanding

PS BUSINESS PARKS, INC.

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PART II. OTHER INFORMATION

Item 6. Exhibits & Reports on Form 8-K 25

<TABLE>
<CAPTION>

PS BUSINESS PARKS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS

| | September 30, 1998 (unaudited) | December 31, 1997 |
|---|---|---|
| **ASSETS** | | |
| <S> | <C> | <C> |
| Cash and cash equivalents | $ 32,747,000 | $ 3,884,000 |
| Real estate facilities, at cost: | | |
| Land | 175,326,000 | 91,754,000 |
| Buildings and equipment | 484,472,000 | 226,466,000 |
| | 659,798,000 | 318,220,000 |
| Accumulated depreciation | (15,104,000) | (3,982,000) |
| | 644,694,000 | 314,238,000 |
| Intangible assets, net | 1,658,000 | 3,272,000 |
| Other assets | 4,332,000 | 2,060,000 |
| Total assets | $ 683,431,000 | $ 323,454,000 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | |
| Accrued and other liabilities | $ 13,794,000 | $ 8,331,000 |
| Mortgage notes payable | 29,632,000 | - |
| Note payable to affiliate | - | 3,500,000 |
| Total liabilities | 43,426,000 | 11,831,000 |
| Minority interest | 152,611,000 | 168,665,000 |
| Shareholders' equity: | | |
| Preferred Stock, $0.01 par value, 50,000,000 shares authorized, none outstanding at September 30, 1998 and December 31, 1997 | - | - |
| Common stock, $0.01 par value, 100,000,000 shares authorized, 23,635,650 shares issued and outstanding at September 30, 1998 (7,728,309 shares issued and outstanding at December 31, 1997) | 236,000 | 77,000 |
| Paid-in capital | 482,327,000 | 143,277,000 |
| Cumulative net income | 24,278,000 | 3,154,000 |
| Cumulative distributions | (19,447,000) | (3,550,000) |
| Total shareholders' equity | 487,394,000 | 142,958,000 |
| Total liabilities and shareholders' equity | $ 683,431,000 | $ 323,454,000 |

See accompanying notes.



</TABLE>
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PS BUSINESS PARKS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

| | For the three months ended September 30, 1998 | For the three months ended September 30, 1997 | For the nine months ended September 30, 1998 | For the nine months ended September 30, 1997 |
|---|---|---|---|---|
| Revenues: | | | | |
| <S> | <C> | <C> | <C> | <C> |
| Rental income | $ 25,635,000 | $ 8,256,000 | $ 61,459,000 | $ 21,039,000 |
| Facility management fees primarily from affiliates | 109,000 | 221,000 | 440,000 | 696,000 |
| Interest and other income | 533,000 | 183,000 | 1,077,000 | 322,000 |

| | | | | |
|---|---|---|---|---|
| | 26,277,000 | 8,660,000 | 62,976,000 | 22,057,000 |
| Expenses: | | | | |
| Cost of operations | 7,379,000 | 3,250,000 | 18,361,000 | 8,269,000 |
| Cost of facility management | 12,000 | 48,000 | 49,000 | 157,000 |
| Depreciation and amortization | 4,865,000 | 1,395,000 | 11,421,000 | 3,410,000 |
| General and administrative | 593,000 | 382,000 | 1,589,000 | 767,000 |
| Interest expense | 667,000 | - | 1,736,000 | - |
| | 13,516,000 | 5,075,000 | 33,156,000 | 12,603,000 |
| Income before minority interest | 12,761,000 | 3,585,000 | 29,820,000 | 9,454,000 |
| Minority interest in income | (3,013,000) | (2,403,000) | (8,696,000) | (6,795,000) |
| Net income | $ 9,748,000 | $ 1,182,000 | $ 21,124,000 | $ 2,659,000 |
| Net income per share: | | | | |
| Basic | $ 0.41 | $ 0.33 | $ 1.18 | $ 1.00 |
| Diluted | $ 0.41 | $ 0.33 | $ 1.17 | $ 1.00 |
| Weighted average shares outstanding: | | | | |
| Basic | 23,635,650 | 3,555,777 | 17,920,028 | 2,652,109 |
| Diluted | 23,695,747 | 3,555,777 | 17,989,772 | 2,652,109 |

</TABLE>

See accompanying notes.



<TABLE>

PS BUSINESS PARKS, INC.
CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
For the nine months ended September 30, 1998
(Unaudited)

| | Preferred Stock | | Common Stock | |
|---|---|---|---|---|
| | Shares | Amount | Shares | Amount |
| <S> | <C> | <C> | <C> | <C> |
| Balances at December 31, 1997 | - | $ - | 7,728,309 | $ 77,000 |
| Issuances of common stock: | | | | |
| Conversion of OP Units | - | - | 1,785,008 | 18,000 |
| Private offerings, net of costs | - | - | 6,774,074 | 68,000 |
| Exercise of stock options | - | - | 39,021 | - |
| In connection with a business combination | - | - | 2,283,438 | 23,000 |
| Public offerings, net of costs | - | - | 5,025,800 | 50,000 |
| Net income | - | - | - | - |
| Distributions paid | - | - | - | - |
| Adjustment to reflect minority interest to underlying ownership interest | - | - | - | - |
| Balances at September 30, 1998 | - | $ - | 23,635,650 | $ 236,000 |

</TABLE>
<TABLE>

PS BUSINESS PARKS, INC.
CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
For the nine months ended September 30, 1998
(Unaudited)

| | Paid-in Capital | Cumulative Net Income | Cumulative Distributions | Total Shareholders' Equity |
|---|---|---|---|---|
| - | | | | |
| <S> | <C> | <C> | <C> | <C> |

| | | | | |
|---|---|---|---|---|
| Balances at December 31, 1997 | $ 143,277,000 | $ 3,154,000 | $ (3,550,000) | $ 142,958,000 |
| Issuances of common stock: | | | | |
| Conversion of OP Units | 33,005,000 | - | - | 33,023,000 |
| Private offering, net of costs | 152,533,000 | - | - | 152,601,000 |
| Exercise of stock options | 651,000 | - | - | 651,000 |
| In connection with a business combination | 46,787,000 | - | - | 46,810,000 |
| Public offerings, net of costs | 118,810,000 | - | - | 118,860,000 |
| Net income | - | 21,124,000 | - | 21,124,000 |
| Distributions paid | - | - | (15,897,000) | (15,897,000) |
| Adjustment to reflect minority interest to underlying ownership interest | (12,736,000) | - | - | (12,736,000) |
| | | | | - |
| Balances at September 30, 1998 | $ 482,327,000 | $ 24,278,000 | $ (19,447,000) | $ 487,394,000 |

</TABLE>

See accompanying notes.



<TABLE>
<CAPTION>

PS BUSINESS PARKS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

| | For the nine months ended September 30, | |
|---|---|---|
| | 1998 | 1997 |
| Cash flows from operating activities: | | |
| <S> | <C> | <C> |
| Net income | $ 21,124,000 | $ 2,659,000 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization expense | 11,421,000 | 3,410,000 |
| Minority interest in income | 8,696,000 | 6,795,000 |
| (Increase) decrease in other assets | (2,620,000) | 289,000 |
| Increase in accrued and other liabilities | 3,221,000 | 1,170,000 |
| Total adjustments | 20,718,000 | 11,664,000 |
| Net cash provided by operating activities | 41,842,000 | 14,323,000 |
| Cash flows from investing activities: | | |
| Acquisition of real estate facilities | (252,649,000) | (43,360,000) |
| Acquisition cost of business combination | (424,000) | - |
| Capital improvements to real estate facilities | (6,030,000) | (2,321,000) |
| Payment received from PSI and affiliates for net property operating liabilities assumed | - | 2,233,000 |
| Net cash used in investing activities | (259,103,000) | (43,448,000) |
| Cash flows from financing activities: | | |
| Borrowings from an affiliate | 179,000,000 | - |
| Repayment of borrowings from an affiliate | (182,500,000) | - |
| Principal payments on mortgage notes payable | (343,000) | - |
| Decrease in receivable from affiliate | - | 781,000 |
| Proceeds from the issuance of common stock, net | 272,112,000 | 33,880,000 |
| Distributions paid to shareholders | (15,897,000) | - |
| Distributions to minority interests | (6,248,000) | - |
| Net cash provided by financing activities | 246,124,000 | 34,661,000 |
| Net increase in cash and cash equivalents | 28,863,000 | 5,536,000 |
| Cash and cash equivalents at the beginning of the period | 3,884,000 | 919,000 |
| Cash and cash equivalents at the end of the period | $ 32,747,000 | $ 6,455,000 |

</TABLE>

See accompanying notes.



<TABLE>
<CAPTION>

PS BUSINESS PARKS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

| | For the nine months ended September 30, 1998 | 1997 |
|---|---|---|
| SUPPLEMENTAL SCHEDULE OF NON CASH INVESTING AND FINANCIAL ACTIVITIES: | | |
| Acquisitions of real estate facilities and associated assets and liabilities in exchange for preferred stock, minority interests, and mortgage notes payable: | | |
| <S> | <C> | <C> |
| Real estate facilities | $(33,584,000) | $(141,480,000) |
| Other assets (deposits on real estate acquisitions) | 800,000 | - |
| Accrued and other liabilities | 1,245,000 | - |
| Minority interest | 1,564,000 | 120,750,000 |
| Preferred stock | - | 100,000 |
| Paid in capital | - | 19,900,000 |
| Mortgage notes payable | 29,975,000 | - |
| Intangible assets | - | 730,000 |
| Business combination: | | |
| Real estate facilities | (48,000,000) | - |
| Other assets | (452,000) | - |
| Accrued and other liabilities | 1,218,000 | - |
| Common stock | 23,000 | - |
| Paid in capital | 46,787,000 | - |
| Conversion of OP Units into shares of common stock: | | |
| Minority interest | (33,023,000) | |
| Common stock | 18,000 | - |
| Paid in capital | 33,005,000 | - |
| Adjustment to reflect minority interest to underlying ownership interest: | | |
| Minority interest | 12,736,000 | - |
| Paid in capital | (12,736,000) | - |
| Exchange of preferred stock for common stock: | | |
| Preferred stock | - | (175,000) |
| Common stock | - | 175,000 |
| Adjustment to acquisition cost (see Note 2): | | |
| Real estate facilities | (1,315,000) | (7,146,000) |
| Accumulated depreciation | - | (820,000) |
| Intangible assets | 1,315,000 | (4,395,000) |
| Paid in capital | - | 12,361,000 |

</TABLE>

See accompanying notes.



PS BUSINESS PARKS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
September 30, 1998

1. ORGANIZATION AND DESCRIPTION OF BUSINESS

ORGANIZATION

PS Business Parks, Inc. ("PSB"), a California corporation, is the successor to American Office Park Properties, Inc. ("AOPP") which merged with and into Public Storage Properties XI, Inc. ("PSP 11") on March 17, 1998 (the "Merger"). The name of the company was changed to "PS Business Parks, Inc." in connection with the Merger. See Note 3 for a description of the Merger and its terms.

Based upon the terms of the Merger, the transaction for financial reporting and accounting purposes has been accounted for as a reverse acquisition whereby AOPP is deemed to have acquired PSP11. However, PSP11 is the continuing legal entity and registrant for both Securities and Exchange filing purposes and income tax reporting purposes. All subsequent references to PSB for periods prior to March 17, 1998 shall refer to AOPP.

PSB was organized in California in 1986 as a wholly-owned subsidiary of Public Storage Management, Inc. ("PSMI"), a privately owned company of B.

Wayne Hughes and his family (collectively "Hughes").

On November 16, 1995, Public Storage, Inc. ("PSI") acquired PSMI in a business combination accounted for using the purchase method. In connection with the transaction, PSI exchanged its common stock for all of the non-voting participating preferred stock of PSB, representing a 95% economic interest, and Hughes purchased all the voting common stock of PSB, representing the remaining 5% economic interest. During December 1996, Ronald L. Havner, Jr. (then an executive officer of PSI) acquired all of Hughes' common stock in PSB.

On January 2, 1997, in connection with the reorganization of the commercial property operations of PSI and affiliated entities, PSB formed a partnership (the "Operating Partnership") whereby PSB became the general partner. Concurrent with the formation of the Operating Partnership, PSI and affiliated entities contributed commercial properties to the Operating Partnership in exchange for limited partnership units ("OP Units"). In addition, PSI contributed commercial properties to PSB in exchange for shares of non-voting participating preferred stock, and such properties were immediately contributed by PSB along with its commercial property management operations and cash to the Operating Partnership for OP Units.

Subject to certain limitations as described in Note 8, holders of OP Units, other than PSB, have the right to require PSB to redeem such holders' OP Units at any time or from time to time beginning on the date that is one year after the date on which such limited partner is admitted to the Operating Partnership.

On March 31, 1997, PSI exchanged its non-voting participating preferred stock into common shares of PSB. As a result of the exchange, PSI owned a majority of the voting common stock and effectively gained control of PSB at that time.

DESCRIPTION OF BUSINESS

PSB is a fully-integrated, self-managed real estate investment trust ("REIT") that acquires, owns and operates commercial properties containing commercial and industrial rental space. From 1986 through 1996, PSB's sole business activity consisted of the management of commercial properties owned primarily by PSI and affiliated entities.

Commencing in 1997, PSB began to own and operate commercial properties for its own behalf. At September 30, 1998, PSB and the Operating Partnership collectively owned and operated 98 commercial properties (approximately 10.3 million net rentable square feet) located in 11 states. In addition, the Operating Partnership managed, on behalf of PSI and affiliated entities, 35 commercial properties (approximately 1.0 million net rentable square feet).





2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. The preparation of the condensed consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. Actual results could differ from estimates. In the opinion of management, all adjustments (consisting of normal recurring accruals) necessary for a fair presentation have been included. Operating results for the three and nine months ended September 30, 1998 are not necessarily indicative of the results that may be expected for the year ended December 31, 1998. For further information, refer to the consolidated financial statements and footnotes of PSB for the year ended December 31, 1997 filed on Form 8-K/A dated April 17, 1998 (amending Form 8-K dated March 17, 1998).

The condensed consolidated financial statements include the accounts of PSB and the Operating Partnership. At September 30, 1998, PSB owned approximately 73% of the OP Units of the Operating Partnership. PSB, as the sole general partner of the Operating Partnership, has full, exclusive and complete responsibility and discretion in managing and controlling the Operating Partnership.

On March 31, 1997, PSB and PSI agreed to exchange the non-voting participating preferred stock held by PSI for 2,098,288 shares of voting common stock of PSB. After the exchange, PSI owned in excess of 95% of the outstanding common voting common stock of PSB and PSB accounted for the transaction as if PSI acquired PSB in a transaction accounted for as a purchase. Accordingly, PSB reflected PSI's cost of its investment in PSB in accordance with Accounting Principles Board Opinion No. 16. As a result of PSI attaining control of PSB, the carrying value of PSB's assets and liabilities were adjusted to reflect PSI's acquisition cost of its controlling interest in PSB of approximately $35 million. As a result, the carrying value of real estate facilities was increased approximately $8.0 million, intangible assets increased approximately $4.4 million and paid in capital increased approximately $12.4 million.

STOCK SPLIT AND STOCK DIVIDEND:

On January 1, 1997, the number of outstanding shares of preferred and common stock increased as a result of a 10 for 1 stock split. In March 1997, the preferred stock of PSB was converted into common stock on a share for share basis. In December 1997, PSB declared a common stock dividend at a rate of .01583 shares for each common share outstanding. Similarly, the Operating Partnership's outstanding OP Units were adjusted to reflect the stock dividend. No adjustment was made to the outstanding OP Units for the January 1997 stock split, as the issuance of OP Units during 1997 already reflected the stock split.

On March 17, 1998, in connection with the merger, PSB's common shares were converted into 1.18 shares of PSP11. Similarly, holders of OP Units received an additional 0.18 OP Units for each outstanding OP Unit held at the time of the merger.

References in the condensed consolidated financial statements and notes thereto with respect to shares of preferred stock, common stock, stock options, and OP Units and the related per share/per unit amounts have been retroactively adjusted to reflect the January 1997 stock split, the December 1997 stock dividend and the March 1998 conversion in connection with the Merger.





CASH AND CASH EQUIVALENTS:

PSB considers all highly liquid investments with an original maturity of three months or less at the date of purchase to be cash equivalents.

REAL ESTATE FACILITIES:

Costs related to the improvements of properties are capitalized. Expenditures for repair and maintenance are charged to expense when incurred. After March 31, 1997, acquisition of facilities from PSI and entities controlled by PSI have been recorded at the predecessor's basis. Buildings and equipment are depreciated on the straight line method over the estimated useful lives, which is generally 25 and 5 years, respectively.

INTANGIBLE ASSETS:

Intangible assets consist of property management contracts for properties managed, but not owned, by PSB. The intangible assets are being amortized over seven years. As properties managed are subsequently acquired by PSB, the unamortized basis of intangible assets related to such property is included in the cost of acquisition of such property. During April 1997, PSB acquired four properties from PSI and included in the cost of real estate facilities for such properties is $730,000 of cost previously classified as intangible assets. In connection with the Merger, PSB acquired 13 properties and included in the cost of such properties is $1,315,000 (which was net of accumulated amortization of $194,000) of costs previously classified as intangible assets. Intangible assets at September 30, 1998 are net of accumulated amortization of $497,000.

EVALUATION OF ASSET IMPAIRMENT:

In 1995, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of" which requires impairment losses to be recorded on long-lived assets. PSB evaluates its assets used in operations, by identifying indicators of impairment and by comparing the sum of the estimated undiscounted future cash flows for each asset to the asset's carrying amount. When indicators of impairment are present and the sum of the undiscounted future cash flows is less than the carrying value of such asset, an impairment loss is recorded equal to the difference between the asset's current carrying value and its value based on discounting its estimated future cash flows. SFAS No. 121 also addresses the accounting for long-lived assets that are expected to be disposed of. Such assets are to be reported at the lower of their carrying amount or fair value, less cost to sell. PSB adopted SFAS No. 121 in 1996 and the adoption had no effect. PSB's subsequent evaluations have indicated no impairment in the carrying amount of its assets.

NOTE PAYABLE TO AND BORROWINGS FROM AFFILIATE:

Note payable to affiliate at December 31, 1997 of $3,500,000 reflects amounts borrowed from PSI on that date. The note bore interest at 6.97% and was repaid on January 31, 1998. On May 1, 1998, PSB borrowed $179,000,000 from PSI to fund a portion of the acquisition cost of real estate facilities. On May 6, 1998, $105.0 million was repaid and the remaining balance was repaid on May 27, 1998. The borrowings bore interest at 6.91% (per annum).

REVENUE AND EXPENSE RECOGNITION:

All leases are classified as operating leases. Rental income is recognized on a straight-line basis over the terms of the leases. Reimbursements from tenants for real estate taxes and other recoverable operating expenses are recognized as revenue in the period the applicable costs are incurred.

Costs incurred in connection with leasing (primarily tenant improvements and leasing commissions) are capitalized and amortized over the lease period.

Property management fees are recognized in the period earned.





NET INCOME PER COMMON SHARE:

In 1997, the FASB issued SFAS No. 128, "Earnings per Share." SFAS No. 128 replaced the calculation of "primary" and "fully diluted" earnings per share with "basic" and "diluted" earnings per share.

"Diluted" shares include the dilutive effect of stock options, while "basic" shares exclude such effect. In addition, weighted average shares utilized in computing basic and diluted earnings per share includes the weighted average participating preferred shares, because such shares were allocated income (subject to certain preferences upon liquidation described below) on an equal per share basis with the common shares.

INCOME TAXES:

During 1997, PSB qualified and intends to continue to qualify as a real estate investment trust ("REIT"), as defined in Section 856 of the Internal Revenue Code. As a REIT, PSB is not taxed on that portion of its taxable income which is distributed to its shareholders provided that PSB meets certain tests. PSB believes it met these tests during 1997. In addition, PSP11 (the legal entity for income tax reporting purposes subsequent to the March 17, 1998 merger) believes it has also met the REIT tests during 1997 and for the nine months ended September 30, 1998. Accordingly, no provision for income taxes has been made in the accompanying financial statements.

GENERAL AND ADMINISTRATIVE EXPENSE:

General and administrative expense includes legal and office expense, state income taxes, executive salaries, cost of acquisition personnel and other such administrative items. Such amounts include amounts incurred by PSI on behalf of PSB, which were subsequently charged to PSB in accordance with the allocation methodology pursuant to the cost allocation and administrative services agreement between PSB and PSI.

ACQUISITION COSTS:

Internal acquisition costs are expensed as incurred.

RECLASSIFICATIONS:

Certain reclassifications have been made to the financial statements for 1997 in order to conform to the 1998 presentation.

3. BUSINESS COMBINATION

On March 17, 1998, AOPP merged into PSP11, a publicly traded real estate investment trust and an affiliate of PSI. Upon consummation of the Merger of AOPP into PSP11, the surviving corporation was renamed "PS Business Parks, Inc." (PSB as defined in Note 1). In connection with the Merger:

* Each outstanding share of PSP11 common stock, which did not elect cash, continued to be owned by current holders. A total of 106,155 PSP11 common shares elected to receive cash of $20.50 per share.

* Each share of PSP11 common stock Series B and each share of PSP11 common stock Series C converted into .8641 shares of PSP11 common

stock.

* Each share of AOPP common stock converted into 1.18 shares of PSP11 common stock.

* Concurrent with the Merger, PSP11 exchanged 11 mini-warehouses and two properties that combine mini-warehouse and commercial space for 11 commercial properties owned by PSI. The fair value of each group of real estate facilities was approximately $48 million.





The Merger has been accounted for as a reverse merger whereby PSB is treated as the accounting acquirer using the purchase method. This has been determined based upon the following: (i) the former shareholders and unitholders of PSB owned in excess of 80% of the merged companies and (ii) the business focus post-Merger will continue to be that of PSB's which includes the acquisition, ownership and management of commercial properties. Prior to the Merger, PSP11's business focus has been primarily on the ownership and operation of its self-storage facilities which represented approximately 81% of its portfolio.

Allocations of the total acquisition cost to the net assets acquired were made based upon the fair value of PSP11's assets and liabilities as of the date of the Merger. The acquisition cost and the fair market values of the assets acquired and liabilities assumed in the Merger are summarized as follows:

| | |
|---|---|
| ACQUISITION COST: | |
| Issuance of common stock......... | $46,810,000 |
| Cash............................ | 424,000 |
| Total acquisition cost....... | $47,234,000 |
| ALLOCATION OF ACQUISITION COST: | |
| Real estate facilities.......... | $48,000,000 |
| Other assets.................... | 452,000 |
| Accrued and other liabilities.... | (1,218,000) |
| Total allocation............ | $47,234,000 |

The historical operating results of PSP11 prior to the Merger have not been included in PSB's historical operating results. Pro forma data for the nine months ended September 30, 1998 and 1997 as though the Merger and related exchange of properties have been effective at the beginning of fiscal 1997 are as follows:

| | Nine months ended September 30, 1998 | 1997 |
|---|---|---|
| Revenues.................................. | $ 64,853 | $ 28,445 |
| Net income................................ | $ 21,908 | $ 4,787 |
| Net income per share - basic................ | $ 1.18 | $ 0.97 |
| Net income per share - diluted............. | $ 1.18 | $ 0.97 |

The pro forma data does not purport to be indicative either of the results of operations that would have occurred had the Merger occurred at the beginning of fiscal 1997 or of the future results of PSB.





4. REAL ESTATE FACILITIES

The activity in real estate facilities for the nine months ended September 30, 1998 is as follows:
<TABLE>
<CAPTION>

| <S> | Land <C> | Buildings <C> | Accumulated Depreciation <C> | Total <C> |
|---|---|---|---|---|
| Balances at December 31, 1997........ | $ 91,754,000 | $ 226,466,000 | $ (3,982,000) | $ 314,238,000 |
| Property acquisitions............... | 69,172,000 | 217,061,000 | - | 286,233,000 |

| | | | | |
|---|---|---|---|---|
| Acquired in connection with the Merger.......................... | 14,400,000 | 33,600,000 | - | 48,000,000 |
| Adjustment from intangible assets.... | - | 1,315,000 | - | 1,315,000 |
| Capital improvements................. | - | 6,030,000 | - | 6,030,000 |
| Depreciation expense................. | - | - | (11,122,000) | (11,122,000) |
| Balances at September 30, 1998....... | $175,326,000 | $ 484,472,000 | $ (15,104,000) | $ 644,694,000 |

</TABLE>
On January 13, 1998, PSB acquired a commercial property (approximately 308,000 net rentable square feet) from an unaffiliated third party for approximately $22,518,000, consisting of cash totaling $22,325,000 (of which $500,000 was paid before December 31, 1997) and the issuance of 8,428 OP Units having a value of approximately $193,000.

In March 1998, PSB acquired two commercial properties (approximately 403,000 net rentable square feet) from unaffiliated third parties for an aggregate cost of approximately $32,916,000, consisting of cash totaling $17,377,000 (of which $300,000 was paid before December 31, 1997), the issuance of 44,250 OP Units having a value of approximately $1,013,000 and the assumption of mortgage notes payable of $14,526,000.

On May 4, 1998, PSB acquired 29 commercial properties (approximately 2.3 million net rentable square feet) from an unaffilated third party for an aggregate cost of approximately $190 million in cash.

In June 1998, PSB acquired three properties (approximately 343,000 net rentable square feet) from unaffiliated third parties for an aggregate cost of approximately $29,101,000, consisting of cash totaling $13,449,000, the issuance of 8,882 OP Units having a value of approximately $203,000 and the assumption of mortgage notes payable of $15,449,000.

On September 30, 1998, PSB acquired a commercial property (approximately 125,000 net rentable square feet) from an unaffiliated third party for approximately $8,473,000, consisting of cash totaling $8,317,000 and the issuance of 6,540 OP Units having a value of approximately $156,000.

## 5. LEASING ACTIVITY

Future minimum rental revenues under non-cancelable leases as of September 30, 1998 with tenants for the above real estate facilities are as follows:

| | |
|---|---|
| 1998 (October - December) | $ 20,727,000 |
| 1999 | 73,934,000 |
| 2000 | 52,696,000 |
| 2001 | 35,247,000 |
| 2002 | 23,586,000 |
| Thereafter | 31,710,000 |
| | $ 237,900,000 |





## 6. REVOLVING LINE OF CREDIT

On August 6, 1998, PSB entered into an unsecured line of credit (the "Credit Agreement") with a commercial bank. The Credit Agreement has a borrowing limit of $100 million and an expiration date of August 5, 2000. The expiration date may be extended by one year on each anniversary of the Credit Agreement. Interest on outstanding borrowings is payable monthly. At the option of the Company, the rate of interest charged is equal to (i) the prime rate or (ii) a rate ranging from the London Interbank Offered Rate ("LIBOR") plus 0.55% to LIBOR plus 0.95% depending on the Company's credit ratings and coverage ratios, as defined (currently LIBOR plus 0.80%). In addition, the Company is required to pay a commitment fee of 0.25% (per annum).

## 7. MORTGAGE NOTES PAYABLE

Mortgage notes at September 30, 1998 consist of the following:
<TABLE>
<CAPTION>

| <S> | <C> |
|---|---|
| 7.125% mortgage note, secured by one commercial property, principal and interest payable monthly, due May 2006 | $ 8,945,000 |
| 8.125% mortgage note, secured by one commercial property, principal and interest payable monthly, due July 2005 | 5,439,000 |
| 8.5% mortgage note, secured by one commercial property, principal and | |

| | |
|---|---|
| interest payable monthly, due July 2007. | 1,950,000 |
| 8% mortgage note, secured by one commercial property, principal and interest payable monthly, due April 2003 | 1,702,000 |
| 7.625% mortgage note, secured by one commercial property, principal and interest payable monthly, due May 2004 | 11,596,000 |
| | $29,632,000 |

</TABLE>





At September 30, 1998, approximate principal maturities of mortgage notes payable are as follows:

| | |
|---|---|
| 1998 (October - December) | $ 263,000 |
| 1999 | 1,103,000 |
| 2000 | 1,190,000 |
| 2001 | 1,285,000 |
| 2002 | 1,386,000 |
| Thereafter | 24,405,000 |
| | $ 29,632,000 |

8. MINORITY INTERESTS

In consolidation, PSB classifies ownership interests in the Operating Partnership, other than its own, as minority interest on the consolidated financial statements. Minority interest in income consists of the minority interests' share of the consolidated operating results.

Subject to certain limitations described below, each limited partner other than PSB has the right to require the redemption of such limited partner's partnership interests at any time or from time to time beginning on the date that is one year after the date on which such limited partner is admitted to the Operating Partnership.

Unless PSB, as general partner, elects to assume and perform the Operating Partnership's obligation with respect to a redemption right, as described below, a limited partner that exercises its redemption right will receive cash from the Operating Partnership in an amount equal to the market value (as defined in the Operating Partnership Agreement) of the partnership interests redeemed. In lieu of the Operating Partnership redeeming the partner for cash, PSB, as general partner, has the right to elect to acquire the partnership interest directly from a limited partner exercising its redemption right, in exchange for cash in the amount specified above or by issuance of one share of PSB common stock for each unit of limited partnership interest redeemed.

A limited partner cannot exercise its redemption right if delivery of shares of PSB common stock would be prohibited under the applicable articles of incorporation, if the general partner believes that there is a risk that delivery of shares of common stock would cause the general partner to no longer qualify as a REIT, would cause a violation of the applicable securities laws, or would result in the Operating Partnership no longer being treated as a partnership for federal income tax purposes.

At September 30, 1998, there were 7,400,951 OP Units owned by minority interests (7,305,355 were owned by PSI and affiliated entities and 95,596 were owned by unaffiliated third parties). On a fully converted basis, assuming all 7,400,951 minority interest OP Units were converted into shares of common stock of PSB at September 30, 1998, the minority interests would own approximately 23.8% of the pro forma common shares outstanding. At the end of each reporting period, PSB determines the amount of equity (book value of net assets) which is allocable to the minority interest based upon this pro forma ownership interest and an adjustment is made to the minority interest, with a corresponding adjustment to paid-in capital, to reflect the minority interests' equity.

9. PROPERTY MANAGEMENT CONTRACTS

The Operating Partnership manages industrial, office and retail facilities for PSI and entities affiliated with PSI, and third party owners. These facilities, all located in the United States, operate under the "Public Storage" or "PS Business Parks" name.

The property management contracts provide for compensation of five percent of the gross revenue of the facilities managed. Under the supervision of the property owners, the Operating Partnership coordinates rental policies, rent collections, marketing activities, the purchase of equipment and supplies, maintenance activities, and the selection and engagement of vendors, suppliers and independent contractors. In addition, the Operating Partnership assists and advises the property owners in establishing policies for the hire, discharge and supervision of employees for the operation of these facilities, including property managers, leasing, billing and maintenance personnel.

The property management contract with PSI is for a seven year term with the term being extended one year each anniversary. The property management contracts with affiliates of PSI are cancelable by either party upon sixty days notice.

10. SHAREHOLDERS' EQUITY

In addition to common and preferred stock, PSB is authorized to issue 100,000,000 shares of Equity Stock. The Articles of Incorporation provide that the Equity Stock may be issued from time to time in one or more series and gives the Board of Directors broad authority to fix the dividend and distribution rights, conversion and voting rights, redemption provisions and liquidation rights of each series of Equity Stock.

On January 7, 1998, a holder of OP Units exercised its option and converted its 1,785,008 OP Units into an equal number of shares of PSB common stock. The conversion resulted in an increase in shareholders' equity and a corresponding decrease in minority interest of approximately $33,023,000 representing the book value of the OP Units at the time of conversion.

In January 1998, PSB entered into an agreement with a group of institutional investors under which PSB agreed to issue up to 6,774,074 shares of common stock at $22.88 per share in cash (an aggregate of $155 million) in separate tranches. The first tranche, representing 2,185,189 shares or $50 million, was issued in January 1998. PSB incurred $2,499,000 in costs associated with the issuance. The remainder of the common shares (4,588,885 common shares) were issued on May 6, 1998 and the net proceeds ($105 million) were used to fund a portion of the cost to acquire commercial properties in May 1998.

In May 1998, PSB completed two common stock offerings, raising net proceeds in aggregate totaling $118.9 million through the issuance of 5,025,800 common shares. A portion of the net proceeds were used in connection with a $190 million property portfolio acquisition.

On March 31, 1998, June 30, 1998 and September 30, 1998, PSB paid quarterly distributions to its common shareholders totaling $4,079,000 ($0.347 per common share), $5,909,000 ($0.25 per common share) and $5,909,000 ($0.25 per common share), respectively.



## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

GENERAL: Private Securities Litigation Reform Act Safe Harbor Statement. In addition to historical information, management's discussion and analysis includes certain forward-looking statements regarding events and financial trends which may affect the Company's future operating results and financial position. Such forward-looking statements are often identified by the words "estimate," "project," "intend," "plan," "expect," "believe," or similar expressions. Such statements are subject to risks and uncertainties that could cause the Company's actual results and financial position to differ materially from that indicated by the forward-looking statement. Such factors include, but are not limited to a change in economic conditions in the various markets served by the Company's operations which would adversely affect the level of demand for rental of commercial space and the cost structure of the Company. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. The Company undertakes no obligation to publicly release the result of any revisions to these forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

HISTORICAL OVERVIEW: PS Business Parks, Inc. ("PSB" or the "Company") is a self-managed, self-advised real estate investment trust that acquires, owns and operates commercial properties. The Company is the sole general partner of PS Business Parks, L.P. (the "Operating Partnership") through which the Company conducts most of its activities and owned, as of September 30, 1998, an approximate 73% partnership interest. Substantially all of the remaining partnership interest is owned by Public Storage, Inc. ("PSI") and its affiliates.

The commercial properties owned by the Company and the Operating Partnership generally include both business park (industrial/flex space) and office space. The industrial space is used for, among other things, light manufacturing and assembly, storage and warehousing, distribution and research and development activities. Most of the office space is occupied by tenants who are also renting industrial space. The commercial properties typically consist of one to ten one-story buildings located on three to 20 acres and contain from approximately 10,000 to 500,000 square feet of rentable space (more than 50,000 square feet in the case of the free-standing properties). A property is typically divided into units ranging in size from 500 to 50,000 square feet. Leases generally range from one to seven years and some tenants have options to extend the original terms of their leases.

During 1997 and the first nine months of fiscal 1998, the Company completed a number of business transactions which have had a significant impact to the Company's comparative operating results for the three and nine months ended September 30, 1998 and 1997:

* MERGER: PSB is the successor to American Office Park Properties, Inc. ("AOPP") which merged with and into Public Storage Properties XI, Inc. ("PSP 11") on March 17, 1998 (the "Merger"). The name of the surviving company was changed to "PS Business Parks, Inc." in connection with the merger.

  Based upon the terms of the Merger, the transaction for financial accounting purposes has been accounted for as a reverse acquisition whereby AOPP is deemed to have acquired PSP11. However, PSP11 is the continuing legal entity and registrant for both Securities and Exchange Commission filing purposes and income tax reporting purposes. All subsequent references to "PSB" or the "Company" for periods prior to March 17, 1998 shall refer to AOPP.

In connection with the Merger, PSP11 exchanged eleven mini-warehouses and two properties that combine mini-warehouse and commercial space for eleven commercial properties owned by PSI. The fair value of the real estate facilities owned by PSP11 and the commercial facilities received by PSP11 was approximately $48 million. As a result of this transaction, PSB acquired 13 properties with a total of approximately 815,000 net rentable square feet.



* PROPERTY ACQUISITIONS: Prior to January 2, 1997, the Company and its Operating Partnership did not have an ownership interest in any properties.

  On January 2, 1997, the Company acquired 35 commercial properties (approximately 3.0 million net rentable square feet) from PSI and affiliated entities in exchange for 1,198,680 shares of non-voting participating preferred stock and 5,824,383 units of the Operating Partnership ("OP Units").

  On April 1, 1997, the Company acquired four commercial properties from PSI (approximately 370,000 net rentable square feet) in exchange for 1,480,968 OP Units.

  On July 31, 1997, the Company acquired two commercial properties (approximately 435,000 net rentable square feet) from an unaffiliated third party for an aggregate cost of approximately $33,310,000 in cash.

  On September 24, 1997, the Company acquired a commercial property (approximately 150,000 net rentable square feet) from an unaffiliated third party for approximately $10,283,000, consisting of cash totaling $9,959,000 and the issuance of 14,384 OP Units.

  On December 10, 1997, the Company acquired a commercial property (approximately 51,000 net rentable square feet) from an unaffiliated third party for approximately $3,854,000, consisting of cash totaling $3,554,000 and the issuance of 13,111 OP Units.

  On December 24, 1997, the Company acquired six commercial properties (approximately 2.0 million net rentable square feet) valued at $118,655,000 and $1,000,000 in cash from a subsidiary of a state pension plan through a merger and contribution. In connection with the transaction, the Company issued 3,504,758 common shares of the Company and 1,785,007 OP Units to the subsidiary of the state pension plan. The Company incurred approximately $3,300,000 in costs in connection with the transaction.

  On January 13, 1998, the Company acquired a commercial property (approximately 308,000 net rentable square feet) from an unaffiliated third party for approximately $22,518,000, consisting of cash totaling $22,325,000 and the issuance of 8,428 OP Units having a value of approximately $193,000.

  In March 1998, the Company acquired two commercial properties (approximately 403,000 net rentable square feet) from unaffiliated third parties for an aggregate cost of approximately $32,916,000, consisting of cash totaling $17,377,000, the issuance of 44,250 OP Units having a value of approximately $1,013,000 and the assumption of mortgage notes payable of $14,526,000.

  On May 4, 1998, the Company acquired 29 commercial properties (approximately 2.3 million net rentable square feet) from an unaffiliated third party for an aggregate cost of approximately $190 million in cash.

In June 1998, the Company acquired three properties (approximately 343,000 net rentable square feet) from unaffiliated third parties for an aggregate cost of approximately $29,101,000, consisting of cash totaling $13,449,000, the issuance of 8,882 OP Units having a value of approximately $203,000 and the assumption of mortgage notes payable of $15,449,000.

On September 30, 1998, the Company acquired a commercial property (approximately 125,000 net rentable square feet) from an unaffiliated third party for approximately $8,473,000, consisting of cash totaling $8,317,000 and the issuance of 6,540 OP Units having a value of approximately $156,000.

* COMMON STOCK ISSUANCES FOR CASH: In connection with the Company's July 1997 acquisition of properties, the Company issued 2,025,769 shares of common stock primarily to PSI for cash totaling $33,800,000.

  In January 1998, the Company entered into an agreement with a group of institutional investors under which the Company agreed to issue up to 6,774,074 shares of common stock at $22.88 per share in separate tranches. The first tranche, representing 2,185,189 shares or $50 million was issued in January 1998. The remainder of the shares were issued on May 6, 1998 for $105 million.



  In May 1998, the Company completed two common stock offerings, raising net proceeds totaling $118.9 million. In the first offering, the Company sold 4,000,000 shares of common stock to an underwriter, resulting in approximately $95.2 million of net proceeds. These shares were resold to various institutional investors. A portion of the proceeds were used to retire debt incurred with a $190 million property portfolio acquisition. In the second common stock offering, the Company sold 1,025,800 common shares to an underwriter, resulting in net proceeds of $23.7 million.

* EXCHANGE OF NON-VOTING PREFERRED STOCK FOR VOTING COMMON STOCK: On March 31, 1997, PSI exchanged its non-voting common stock for voting common stock of the Company in a transaction accounted for as a purchase of PSB by PSI. As a result of PSI attaining a 95% ownership interest in PSB voting common stock, PSB reflected PSI's cost of its investment in PSB in accordance with Accounting Principles Board Opinion No. 16. As a result of PSI attaining control of PSB, the carrying value of PSB's assets and liabilities were adjusted to reflect PSI's acquisition cost of its controlling interest in PSB of approximately $35 million. As a result, the carrying value of real estate facilities was increased at March 31, 1997 by approximately $8.0 million, intangible assets increased by approximately $4.4 million and paid in capital increased by approximately $12.4 million.

RESULTS OF OPERATIONS

THREE AND NINE MONTHS ENDED SEPTEMBER 30, 1998 COMPARED TO THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 1997: Net income for the three months ended September 30, 1998 was $9,748,000 compared to $1,182,000 for the same period in 1997. Net income for the nine months ended September 30, 1998 was $21,124,000 compared to $2,659,000 for the same period in 1997. Net income per common share on a diluted basis was $0.41 (based on weighted average diluted shares outstanding of 23,695,747) for the three months ended September 30, 1998 compared to net income per common share on a diluted basis of $0.33 (based on diluted weighted average shares outstanding of 3,555,777) for the three months ended September 30, 1997, representing an increase of 24.2%. Net income per common share on a diluted basis was $1.17 (based on weighted average diluted shares outstanding of 17,989,772) for the nine months ended September 30, 1998 compared to net income per common share on a diluted basis of $1.00 (based on diluted weighted average shares outstanding of 2,652,109) for the nine months ended September 30, 1997, representing an increase of 17.0%. The increases in net income and net income per share reflects the Company's significant growth in its asset base through the acquisition of commercial properties and increase in net operating income from the consistent group of properties.



PROPERTY OPERATIONS: The Company's property operations account for almost all of the net operating income earned by the Company. The following table presents the operating results of the properties for the three and nine months ended September 30, 1998 and 1997:
<TABLE>
<CAPTION>

| | Three months ended September 30, | | | Nine months ended September 30, | | |
|---|---|---|---|---|---|---|
| | 1998 | 1997 | Change | 1998 | 1997 | Change |
| Rental income: | | | | | | |
| Facilities owned throughout each period (35 facilities, 3.0 million net | | | | | | |

| | | | | | | |
|---|---|---|---|---|---|---|
| <S> | <C> | <C> | <C> | <C> | <C> | <C> |
| rentable square feet)................ | $ 6,314,000 | $6,032,000 | 4.7% | $18,695,000 | $17,896,000 | 4.5% |
| Facilities acquired between March 31, 1997 and June 30, 1998 (62 facilities, 7.2 million net rentable square feet)......................... | 19,321,000 | 2,224,000 | 768.8% | 42,764,000 | 3,143,000 | 1,260.6% |
| Total rental income.................... | $25,635,000 | $8,256,000 | 210.5% | $61,459,000 | $21,039,000 | 192.1% |
| Cost of operations (excluding depreciation): | | | | | | |
| Facilities owned throughout each period. | $2,599,000 | $2,576,000 | 0.9% | $ 7,560,000 | $ 7,439,000 | 1.6% |
| Facilities acquired between March 31, 1997 and June 30, 1998............... | 4,780,000 | 674,000 | 609.2% | 10,801,000 | 830,000 | 1,201.3% |
| Total cost of operations............... | $7,379,000 | $3,250,000 | 127.0% | $18,361,000 | $8,269,000 | 122.0% |
| Net operating income (rental income less cost of operations): | | | | | | |
| Facilities owned throughout each period. | $3,715,000 | $3,456,000 | 7.5% | $11,135,000 | $10,457,000 | 6.5% |
| Facilities acquired between March 31, 1997 and June 30, 1998............... | 14,541,000 | 1,550,000 | 838.1% | 31,963,000 | 2,313,000 | 1,281.9% |
| Total net operating income............. | $18,256,000 | $5,006,000 | 264.7% | $43,098,000 | $12,770,000 | 237.5% |
| Other operating data: | | | | | | |
| For the facilities owned throughout each period: | | | | | | |
| Annualized realized rent per occupied square foot.......................... | $8.85 | $8.52 | 3.9% | $ 8.77 | $8.41 | 4.3% |
| Weighted average occupancy for the period............................... | 94.7% | 94.0% | 0.7% | 94.1% | 93.9% | 0.2% |

</TABLE>
<TABLE>
<CAPTION>
Rental income and net operating income ("NOI") are summarized for the three months ended September 30, 1998 by major geographical region below:

| Region | Rental Income | Percentage of Total | NOI | Percentage of Total |
|---|---|---|---|---|
| <S> | <C> | <C> | <C> | <C> |
| Southern California | $7,676,000 | 29.9% | $5,540,000 | 30.3% |
| Northern California | 2,013,000 | 7.9% | 1,455,000 | 8.0% |
| Virginia/Maryland | 6,640,000 | 25.9% | 4,817,000 | 26.4% |
| Texas | 4,347,000 | 17.0% | 2,749,000 | 15.1% |
| Oregon | 3,558,000 | 13.9% | 2,851,000 | 15.6% |
| Other | 1,401,000 | 5.4% | 844,000 | 4.6% |
| Total | $25,635,000 | 100.0% | $18,256,000 | 100.0% |

</TABLE>

SUPPLEMENTAL PROPERTY DATA AND TRENDS: In order to evaluate how the Company's overall portfolio has performed, management analyzes the operating performance of a consistent group of 51 properties (4.2 million net rentable square feet). These 51 properties represent a mature group of properties which have been managed by the Company for at least three years and, as of March 17, 1998, were owned by the Company. The table below summarizes the historical operations of the 51 properties for the three and nine months ended September 30, 1998 and 1997; however, the Company did not own all of the properties throughout the periods presented and therefore, such operations are not all reflected in the Company's historical operating results.



<TABLE>
<CAPTION>
The following table summarizes the pre-depreciation historical operating results of these "Same Park" facilities:

| | Three months ended September 30, | | |
|---|---|---|---|
| | 1998 (1) | 1997 (1) | Change |
| <S> | <C> | <C> | <C> |
| Rental income (2).................................... | $9,820,000 | $9,275,000 | 5.9% |
| Cost of operations................................... | 3,934,000 | 3,920,000 | 0.4% |

| | | | |
|---|---|---|---|
| Net operating income................................ | $5,886,000 | $5,355,000 | 9.9% |
| Gross margin (3).................................. | 59.9% | 57.7% | 2.2% |
| Annualized realized rent per occupied square foot (4).. | $9.85 | $9.26 | 6.4% |
| Weighted average occupancy for the period............. | 95.7% | 95.8% | (0.1)% |

| | Nine months ended September 30, | | |
|---|---|---|---|
| | 1998 (1) | 1997 (1) | Change |
| Rental income (2)..................................... | $28,977,000 | $27,451,000 | 5.6% |
| Cost of operations ................................... | 11,155,000 | 11,160,000 | -% |
| Net operating income................................ | $17,822,000 | $16,291,000 | 9.4% |
| Gross margin (3).................................. | 61.5% | 59.3% | 2.2% |
| Annualized realized rent per occupied square foot (3).. | $9.67 | $9.12 | 6.0% |
| Weighted average occupancy for the period............. | 95.4% | 95.8% | (0.4)% |

</TABLE>

(1) Operations for the three and nine months ended September 30, 1998 represent the historical operations of the 51 properties; however, the Company did not own all of the properties throughout all periods presented and therefore such operations are not reflected in the Company's historical operating results. All such properties were owned effective March 17, 1998.

(2) Rental income does not include the effect of straight line accounting.

(3) Gross margin is computed by dividing property net operating income by rental income.

(4) Realized rent per square foot represents the actual revenue earned per occupied square foot.

<TABLE>

The following tables summarize by major geographic region the operating results displayed above:

THREE MONTH RESULTS
- -------------------

<CAPTION>

| | Revenues 1998 | Revenues 1997 | Percentage Increase | NOI 1998 | NOI 1997 | Percentage Increase |
|---|---|---|---|---|---|---|
| <S> | <C> | <C> | <C> | <C> | <C> | <C> |
| Southern California | $3,767,000 | $3,613,000 | 4.3% | $2,382,000 | $2,200,000 | 8.3% |
| Northern California | 1,430,000 | 1,315,000 | 8.7% | 949,000 | 839,000 | 13.1% |
| Texas | 1,670,000 | 1,632,000 | 2.3% | 795,000 | 780,000 | 1.9% |
| Virginia/Maryland | 1,359,000 | 1,231,000 | 10.4% | 839,000 | 698,000 | 20.2% |
| Arizona | 692,000 | 632,000 | 9.5% | 373,000 | 331,000 | 12.7% |
| Other | 902,000 | 852,000 | 5.9% | 548,000 | 507,000 | 8.1% |
| Total | $9,820,000 | $9,275,000 | 5.9% | $5,886,000 | $5,355,000 | 9.9% |

</TABLE>



<TABLE>

NINE MONTH RESULTS
- ------------------

<CAPTION>

| | Revenues 1998 | Revenues 1997 | Percentage Increase | NOI 1998 | NOI 1997 | Percentage Increase |
|---|---|---|---|---|---|---|
| <S> | <C> | <C> | <C> | <C> | <C> | <C> |
| Southern California | $11,150,000 | $10,675,000 | 4.4% | $7,131,000 | $6,600,000 | 8.0% |
| Northern California | 4,224,000 | 3,900,000 | 8.3% | 2,860,000 | 2,599,000 | 10.0% |
| Texas | 4,938,000 | 4,845,000 | 1.9% | 2,476,000 | 2,444,000 | 1.3% |
| Virginia/Maryland | 3,940,000 | 3,697,000 | 6.6% | 2,459,000 | 2,060,000 | 19.4% |
| Arizona | 2,027,000 | 1,851,000 | 9.5% | 1,225,000 | 1,101,000 | 11.3% |
| Other | 2,698,000 | 2,483,000 | 8.7% | 1,671,000 | 1,487,000 | 12.4% |
| Total | $28,977,000 | $27,451,000 | 5.6% | $17,822,000 | $16,291,000 | 9.4% |

</TABLE>

The increases noted above reflect the strength of our existing markets. All major markets except Dallas, Texas have shown increases in occupancy and rental rates without corresponding increases in expenses. Texas has underperformed the rest of the portfolio due to temporary vacancies in our "Same Park" Dallas facilities. In addition, the Texas properties incurred higher utility costs due to unusually hot weather during the third quarter.

FACILITY MANAGEMENT OPERATIONS: The Company's facility management accounts for a small portion of the Company's net operating income. During the three months ended September 30, 1998, $97,000 in net operating income was recognized from facility management operations compared to $173,000 for the same period in 1997. During the nine months ended September 30, 1998, $391,000 in net operating income was recognized from facility management operations compared to $539,000 for the same period in 1997. Facility management fees have decreased due to the Company's acquisition of properties previously managed.

INTEREST AND OTHER INCOME: Interest and other income primarily reflect earnings on cash balances. Interest income was $533,000 for the three months ended September 30, 1998 compared to $183,000 for the same period in 1997. Interest income was $1,077,000 for the nine months ended September 30, 1998 compared to $322,000 for the same period in 1997. The increases are attributable to increased average cash balances primarily due to the Company's issuance of common stock in January and May 1998 and the timing of investing these funds in newly acquired real estate facilities. Average cash balances for the three and nine months ended September 30, 1998 were approximately $28 million and $41 million, respectively, compared to $8 million and $13 million for the same periods in 1997.

DEPRECIATION AND AMORTIZATION EXPENSE: Depreciation and amortization expense for the three months ended September 30, 1998 was $4,865,000 compared to $1,395,000 for the same period in 1997. Depreciation and amortization expense for the nine months ended September 30, 1998 was $11,421,000 compared to $3,410,000 for the same period in 1997. The increases are due to the acquisition of real estate facilities in 1997 and 1998.

GENERAL AND ADMINISTRATIVE EXPENSE: General and administrative expense was $593,000 for the three months ended September 30, 1998 compared to $382,000 for the same period in 1997. General and administrative expense was $1,589,000 for the nine months ended September 30, 1998 compared to $767,000 for the same period in 1997. The increase is due to the increased scope and acquisition activities of the Company.

INTEREST EXPENSE: Interest expense was $667,000 and $1,736,000 for the three and nine months ended September 30, 1998 (none for the same periods in 1997). Interest expense for 1998 is attributable to mortgage notes assumed in connection with the acquisition of real estate facilities in March and June 1998, short-term borrowings in connection with an acquisition and the amortization of line of credit facility costs.

MINORITY INTEREST IN INCOME: Minority interest in income reflects the income allocable to equity interests in the Operating Partnership which are not owned by the Company. Minority interest in income for the three months ended September 30, 1998 was $3,013,000 compared to $2,403,000 for the same period in 1997. Minority interest in income for the nine months ended September 30, 1998 was $8,696,000 compared to $6,795,000 for the same period in 1997. The increases in minority interest in income are due to improved operating results and the issuance of additional Operating Partnership units, primarily in connection with the acquisition of real estate facilities on April 1, 1997.



LIQUIDITY AND CAPITAL RESOURCES

Net cash provided by operating activities for the nine months ended September 30, 1998 and 1997 was $41,842,000 and $14,323,000, respectively. Management believes that its internally generated net cash provided by operating activities will continue to be sufficient to enable it to meet its operating expenses, capital improvements, debt service requirements and distributions to shareholders and holders of OP Units for the foreseeable future.

The following table summarizes the Company's ability to make capital improvements to maintain its facilities through the use of cash provided by operating activities. The remaining cash flow is available to the Company to pay distributions to shareholders and acquire property interests.

<TABLE>
<CAPTION>

| | Nine months ended September 30, 1998 | 1997 |
|---|---|---|
| <S> | <C> | <C> |
| Net income | $ 21,124,000 | $ 2,659,000 |
| Depreciation and amortization | 11,421,000 | 3,410,000 |
| Change in working capital | 601,000 | 1,459,000 |
| Minority interest in income | 8,696,000 | 6,795,000 |
| Net cash provided by operating activities | 41,842,000 | 14,323,000 |
| Maintenance capital expenditures | (2,117) | (1,143) |
| Tenant improvements | (2,588) | (891) |
| Capitalized lease commissions | (1,325) | (287) |
| Funds available for distributions to shareholders, minority interests, acquisitions and other corporate purposes | 35,812,000 | 12,002,000 |
| Cash distributions to shareholders and minority interests | (22,145,000) | - |
| Excess funds available for acquisitions and other corporate purposes | $ 13,667,000 | $12,002,000 |

</TABLE>

The Company's capital structure is characterized by a low level of leverage. As of September 30, 1998, the Company had five fixed rate mortgage notes payable totaling $29,632,000, which represented 4% of its total capitalization (based on book value, including minority interests and debt). The weighted average interest rate is 7.6%.

On August 6, 1998, PSB entered into an unsecured line of credit (the "Credit Agreement") with a commercial bank. The Credit Agreement has a borrowing limit of $100 million and an expiration date of August 5, 2000. The expiration date may be extended by one year on each anniversary of the Credit Agreement. Interest on outstanding borrowings is payable monthly. At the option of the Company, the rate of interest charged is equal to (i) the prime rate or (ii) a rate ranging from the London Interbank Offered Rate ("LIBOR") plus 0.55% to LIBOR plus 0.95% depending on the Company's credit ratings and coverage ratios, as defined (currently LIBOR plus 0.80%). In addition, the Company is required to pay a commitment fee of 0.25% (per annum).

The Company expects to fund its growth strategies with cash on hand, internally generated retained cash flows and temporary borrowings from its line of credit. The Company intends to repay amounts borrowed under the credit facility from undistributed cash flow or, as market conditions permit and as determined to be advantageous, from the public or private placement of preferred and common stock or formation of joint ventures.

In January 1998, the Company entered into an agreement with institutional investors whereby the Company agreed to issue 6,774,074 shares of its common stock for cash ($155 million) in separate tranches. The first tranche, representing 2,185,189 shares or $50 million, was issued in January 1998. The Company incurred $2,400,000 in costs associated with the issuance. The remainder of the common shares (4,588,885 common shares) were issued on May 6, 1998 and the net proceeds ($105 million) were used to repay short-term borrowings.

In May 1998, the Company completed two common stock offerings, raising net proceeds totaling $118.9 million. In the first offering, the Company sold 4,000,000 shares of common stock to an underwriter, resulting in approximately $95.2 million of net proceeds. These shares were resold to various institutional investors. A portion of the proceeds were used to retire debt incurred with a $190 million property portfolio acquisition. In the second common stock offering, the Company sold 1,025,800 common shares to an underwriter, resulting in net proceeds of $23.7 million.



FUNDS FROM OPERATIONS: Funds from operations ("FFO") is defined by the Company as net income, computed in accordance with generally accepted accounting principles ("GAAP"), before depreciation, amortization, straight line rent adjustments and extraordinary or non-recurring items. FFO is presented because the Company considers FFO to be a useful measure of the operating performance of a REIT which, together with net income and cash flows, provides investors with a basis to evaluate the operating and cash flow performances of a REIT. FFO does not represent net income or cash flows from operations as defined by GAAP. FFO does not take into consideration scheduled principal payments on debt and capital improvements. Accordingly, FFO is not necessarily a substitute for cash flow or net income as a measure of liquidity or operating performance or ability to make acquisitions and capital improvements or ability to pay distributions or debt principal payments. Also, FFO as computed and disclosed by the Company may not be comparable to FFO computed and disclosed by other REITs.

Funds from operations for the Company is computed as follows:
<TABLE>
<CAPTION>

| | Nine months ended September 30, | |
|---|---|---|
| | 1998 | 1997 |
| <S> | <C> | <C> |
| Net income | $ 21,124,000 | $ 2,659,000 |
| Minority interest in income | 8,696,000 | 6,795,000 |
| Depreciation and amortization | 11,421,000 | 3,410,000 |
| Effects of straight line rents | (924,000) | - |
| Subtotal | 40,317,000 | 12,864,000 |
| FFO allocated to minority interests | (11,757,000) | (9,246,000) |
| Funds from operations allocated to shareholders | $ 28,560,000 | $ 3,618,000 |

</TABLE>

DISTRIBUTIONS: The Company has elected and intends to qualify as a REIT for federal income tax purposes. As a REIT, the Company must meet, among other tests, sources of income, share ownership and certain asset tests. In addition, the Company is not taxed on that portion of its taxable income which is distributed to its shareholders provided that at least 95% of its taxable income is so distributed to its shareholders prior to filing of its tax return.

On November 5, 1998, the Company declared a regular dividend of $0.25 per share payable on December 31, 1998 to shareholders of record on December 15, 1998. The Board of Directors has established a distribution policy to maximize the retention of operating cash flow and only distribute the minimum amount required for the Company to maintain its tax status as a REIT.

IMPACT OF YEAR 2000

The Company utilizes PSI's information systems in connection with a cost sharing and administrative services agreement. The Company and PSI have completed an assessment of all of its hardware and software applications including those affecting the Company to identify susceptibility to what is commonly referred to as the "Y2K Issue" whereby certain computer programs have been written using two digits rather than four to define the applicable year. Certain computer programs or hardware with the Y2K Issue have date-sensitive applications or embedded chips that may recognize a date using "00" as the year 1900 rather than the year 2000, resulting in miscalculations or system failure causing disruptions to operations.

The Company in conjunction with PSI has an implementation in process for critical applications, including its general ledger and related systems, that are believed to have Y2K issues. PSI and the Company expect the implementation to be complete by June 1999. Contingency plans have been developed for use in case the implementations are not completed on a timely basis. The Company presently believes that the impact of the Y2K Issue on its systems can be mitigated. However, if the plan for ensuring Year 2000 compliance and the related contingency plans were to fail, be insufficient, or not be implemented on a timely basis, operations of the Company could be materially impacted.

Certain of the Company's other non-computer related systems that may be impacted by the Y2K Issue, such as security systems, are currently being evaluated, and the Company expects the evaluation to be complete by June 1999. The Company expects the implementation of any required solutions to be complete in advance of December 31, 1999. The Company has not fully evaluated the impact of lack of Year 2000 compliance on these systems, but has no reason to believe that lack of compliance would materially impact its operations.

The Company exchanges electronic data with certain outside vendors in the banking and payroll processing areas. The Company has been advised by these vendors that their systems are or will be Year 2000 compliant and has requested a Year 2000 compliance certification from these entities. The Company is not aware of any other vendors, suppliers, or other external agents with a Y2K Issue that would materially impact the Company's results of operations, liquidity, or capital resources. However, the Company has no means of ensuring that external agents will be Year 2000 compliant, and there can be no assurance that the Company has identified all such external agents. The inability of external agents to complete their Year 2000 compliance process in a timely fashion could materially impact the Company. The effect of non-compliance by external agents is not determinable.

The total cost of PSI's year 2000 compliance activities (which primarily consists of the costs of new systems) will be allocated to all entities that use the PSI computer systems. The amount to be allocated to the Company is estimated at approximately $500,000. These costs are or will be capitalized.

The costs of the projects and the date on which PSI and the Company believe that it will be Year 2000 compliant are based upon management's best estimates, and were derived utilizing numerous assumptions of future events. There can be no assurance that these estimates will be achieved, and actual results could differ materially from those anticipated. There can be no assurance that PSI and the Company have identified all potential Y2K Issues either within the Company or at external agents. In addition, the impact of the Y2K issue on governmental entities and utility providers and the resultant impact on the Company, as well as disruptions in the general economy, may be material but cannot be reasonably determined or quantified.



PART II. OTHER INFORMATION

Item 6. Exhibits and Reports on Form 8-K

(a) The following exhibits are included herein:

(11) Statement re: Computation of Earnings per Share

(12) Statement re: Computation of Ratio of Earnings to Fixed Charges

(27) Financial Data Schedule

(b) Reports on Form 8-K

The Registrant filed a Current Report on Form 8-K dated September 30, 1998 (filed October 13, 1998) pursuant to Item 5 which reported the acquisition of properties from various third parties. The Registrant filed a Current Report on Form 8-K/A dated September 30, 1998 amending Form 8-K dated September 30, 1998 (filed November 13, 1998) pursuant to Items 5 and 7 which filed financial statements for those properties.

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.

Dated: November 16, 1998

PS BUSINESS PARKS, INC.

BY: /s/ Jack Corrigan

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Jack Corrigan

Vice President and Chief Financial Officer

PS BUSINESS PARKS, INC.

Exhibit 11: Statement re: Computation of Earnings per Share

<TABLE>
<CAPTION>

| | For the Three Months Ended September 30, 1998 | For the Three Months Ended September 30, 1997 | For the Nine Months Ended September 30, 1998 | For the Nine Months Ended September 30, 1997 |
|---|---|---|---|---|
| <S> | <C> | <C> | <C> | <C> |
| BASIC AND DILUTED EARNINGS PER SHARE: | | | | |
| Net income and net income allocable to common shareholders (same for Basic and Diluted computations)....................................... | $9,748,000 | $1,182,000 | $21,124,000 | $2,659,000 |
| Weighted average common shares outstanding: | | | | |
| Basic weighted average common shares outstanding.......... | 23,635,650 | 3,555,777 | 17,920,028 | 2,652,109 |
| Net effect of dilutive stock options - based on treasury stock method using average market price................ | 60,097 | - | 69,744 | - |
| Diluted weighted average common shares outstanding........ | 23,695,747 | 3,555,777 | 17,989,772 | 2,652,109 |
| Basic earnings per common share............................. | $ 0.41 | $ 0.33 | $ 1.18 | $ 1.00 |
| Diluted earnings per common share........................... | $ 0.41 | $ 0.33 | $ 1.17 | $ 1.00 |

</TABLE>

PS BUSINESS PARKS, INC.
Exhibit 12: Statement re: Computation of Ratio of Earnings to Fixed Charges

<TABLE>
<CAPTION>

| | Nine Months Ended September 30, 1998 | Nine Months Ended September 30, 1997 |
|---|---|---|
| | (Amounts in thousands, except ratios) | |
| <S> | <C> | <C> |
| Net income | $ 21,124,000 | $ 2,659,000 |
| Add: minority interest | 8,696,000 | 6,795,000 |
| Less: minority interest that does not have fixed charges | - | (6,795,000) |
| | 29,820,000 | 2,659,000 |
| Add: Interest expense | 1,736,000 | - |
| Earnings available to cover fixed charges | $ 31,556,000 | $ 2,659,000 |
| Fixed charges (interest expense) | $ 1,736,000 | $ - |
| Ratio of earnings to fixed charges | 18.18 | NA |

</TABLE>
<TABLE>
<CAPTION>

| | Year Ended December 31, 1997 | 1996 | 1995 | 1994 | 1993 |
|---|---|---|---|---|---|
| | (Amounts in thousands, except ratios) | | | | |
| <S> | <C> | <C> | <C> | <C> | <C> |
| Net income before taxes | $ 3,836 | $ 519 | $ 1,192 | $ 1,245 | $ 1,517 |
| Minority interest | 8,566 | - | - | - | - |
| | 12,402 | 519 | 1,192 | 1,245 | 1,517 |
| Interest expense | 1 | - | - | - | - |
| Earnings available to cover fixed charges | $ 12,403 | $ 519 | $ 1,192 | $ 1,245 | $ 1,517 |
| Fixed charges - interest expense | $ 1 | $ - | $ - | $ - | $ - |
| Ratio of earnings to fixed charges | 12,403 | NA | NA | NA | NA |



</TABLE>

<TABLE> <S> <C>

<ARTICLE> 5

<LEGEND>

PS BUSINESS PARKS. INC.
EXHIBIT 27 - FINANCIAL DATA SCHEDULE
ARTICLE 5 OF REGULATION S-X

</LEGEND>

| | |
|---|---|
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| <NAME> | PS Business Parks, Inc. |
| <MULTIPLIER> | 1 |
| <CURRENCY> | U.S. $ |
| <S> | <C> |
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| <PERIOD-END> | SEP-30-1998 |
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| <OTHER-SE> | 487,158,000 |
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| <EPS-DILUTED> | 1.17 |

</TABLE>