SL GREEN REALTY CORP
Form 10-Q
November 09, 2006

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

FORM 10-Q

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

For the quarterly period ended September 30, 2006

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

For the transition period from _______ to ________.

Commission File Number: 1-13199

SL GREEN REALTY CORP.

(Exact name of registrant as specified in its charter)

Maryland	**T13-3956775T**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

420 Lexington Avenue, New York, New York 10170
(Address of principal executive offices) (Zip Code)

(212) 594-2700
(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 x NO o

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.

Large accelerated filer x Accelerated filer o Non-accelerated filer o

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

The number of shares outstanding of the registrant s common stock, $0.01 par value, was 45,818,570 as of October 31, 2006.

SL GREEN REALTY CORP.

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PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

SL Green Realty Corp.
Condensed Consolidated Balance Sheets
(Amounts in thousands, except per share data)

	September 30, 2006 (Unaudited)	December 31, 2005
Assets		
Commercial real estate properties, at cost:		
Land and land interests	**$ 349,073**	$ 288,239
Building and improvements	**1,671,234**	1,440,584
Building leasehold and improvements	**705,900**	481,891
Property under capital lease	**12,208**	12,208
	2,738,415	2,222,922
Less: accumulated depreciation	**(253,136)**	(219,295)
	2,485,279	2,003,627
Assets held for sale	**121,962**	
Cash and cash equivalents	**176,444**	24,104
Restricted cash	**227,482**	60,750
Tenant and other receivables, net of allowance of $12,608 and $9,681 in 2006 and 2005, respectively	**32,037**	23,722
Related party receivables	**9,563**	7,707
Deferred rents receivable, net of allowance of $10,298 and $8,698 in 2006 and 2005, respectively	**85,242**	75,294
Structured finance investments, net of discount of $2,027 and $1,537 in 2006 and 2005, respectively	**347,558**	400,076
Investments in unconsolidated joint ventures	**549,040**	543,189
Deferred costs, net	**74,223**	79,428
Other assets	**117,976**	91,880
Total assets	**$ 4,226,806**	$ 3,309,777
Liabilities and Stockholders Equity		
Mortgage notes payable	**$ 1,255,325**	$ 885,252
Revolving credit facilities	**-**	32,000
Term loans	**525,000**	525,000
Accrued interest payable	**9,353**	7,711
Accounts payable and accrued expenses	**96,741**	87,390
Deferred revenue/gain	**63,358**	25,691
Capitalized lease obligation	**16,359**	16,260
Deferred land leases payable	**16,782**	16,312
Dividend and distributions payable	**33,247**	31,103
Security deposits	**28,368**	24,556
Liabilities related to assets held for sale	**95,379**	
Junior subordinate deferrable interest debentures held by trusts that issued trust preferred securities	**100,000**	100,000
Total liabilities	**2,239,912**	1,751,275
Commitments and Contingencies		
Minority interest in Operating Partnership	**71,910**	74,049
Minority interests in other partnerships	**56,929**	25,012
Stockholders Equity		

Series C preferred stock, $0.01 par value, $25.00 liquidation preference, 6,300 issued and outstanding at September 30, 2006 and December 31, 2005, respectively	**151,981**	151,981
Series D preferred stock, $0.01 par value, $25.00 liquidation preference, 4,000 issued and outstanding at September 30, 2006 and December 31, 2005, respectively	**96,321**	96,321
Common stock, $0.01 par value 100,000 shares authorized and 45,774 and 42,456 issued and outstanding at September 30, 2006 and December 31, 2005, respectively	**458**	425
Additional paid-in-capital	**1,268,491**	959,858
Accumulated other comprehensive income	**13,060**	15,316
Retained earnings	**327,744**	235,540
Total stockholders equity	**1,858,055**	1,459,441
Total liabilities and stockholders equity	**$ 4,226,806**	$ 3,309,777

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

SL Green Realty Corp.
Condensed Consolidated Statements of Income
(Unaudited, and amounts in thousands, except per share data)

	Three Months Ended September 30,		Nine months Ended September 30,	
	2006	**2005**	**2006**	**2005**
Revenues				
Rental revenue, net	$ 93,233	$ 72,575	$ 263,904	$ 210,972
Escalation and reimbursement	19,891	15,474	51,171	39,553
Preferred equity and investment income	15,714	10,652	46,499	33,723
Other income	9,517	16,897	30,892	29,805
Total revenues	138,355	115,598	392,466	314,053
Expenses				
Operating expenses including approximately $3,400, $9,600 (2006) and $3,000, $7,600 (2005) paid to affiliates	34,920	27,213	93,662	72,529
Real estate taxes	19,101	14,638	56,613	43,553
Ground rent	4,846	4,835	14,687	14,089
Interest	24,764	20,580	66,515	57,253
Amortization of deferred financing costs	1,140	1,887	3,096	3,586
Depreciation and amortization	19,289	14,763	53,493	42,779
Marketing, general and administrative	13,829	13,418	40,072	32,250
Total expenses	117,889	97,334	328,138	266,039
Income from continuing operations before equity in net income of unconsolidated joint ventures, minority interest and discontinued operations	20,466	18,264	64,328	48,014
Equity in net income from unconsolidated joint ventures	9,679	13,250	30,244	38,643
Income from continuing operations before minority interest and discontinued operations	30,145	31,514	94,572	86,657
Equity in net gain on sale of interest in unconsolidated joint ventures		11,550		11,550
Minority interest in other partnerships	(1,392)	(38)	(3,359)	(252)
Minority interest in Operating Partnership attributable to continuing operations	(1,321)	(2,142)	(3,733)	(4,727)
Income from continuing operations	27,432	40,884	87,480	93,228
Net income from discontinued operations, net of minority interest	1,595	1,415	4,497	4,530
Gain on sale of discontinued operations, net of minority interest	94,631		94,410	33,856
Net income	123,658	42,299	186,387	131,614
Preferred stock dividends	(4,969)	(4,969)	1(14,906)	(14,906)
Net income available to common stockholders	$ 118,689	$ 37,330	$ 171,481	$ 116,708
Basic earnings per share:				
Net income from continuing operations before discontinued operations	$ 0.50	$ 0.58	$ 1.66	$ 1.60
Net income from discontinued operations	0.03	0.03	0.10	0.11
Gain on sale of discontinued operations	2.09		2.16	0.81
Gain on sale of unconsolidated joint ventures		0.28		0.28
Net income available to common stockholders	$ 2.62	$ 0.89	$ 3.92	$ 2.80
Diluted earnings per share:				
Net income from continuing operations before discontinued operations	$ 0.48	$ 0.58	$ 1.60	$ 1.57
Net income from discontinued operations	0.03	0.03	0.10	0.11
Gain on sale of discontinued operations	2.02		2.08	0.79
Gain on sale of unconsolidated joint ventures		0.26		0.25
Net income available to common stockholders	$ 2.53	$ 0.87	$ 3.78	$ 2.72
Dividends per share	$ 0.60	$ 0.54	$ 1.80	$ 1.62
Basic weighted average common shares outstanding	45,277	41,923	43,784	41,674
Diluted weighted average common shares and common share equivalents outstanding	49,215	45,674	47,718	45,426

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

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SL Green Realty Corp.
Condensed Consolidated Statement of Stockholders Equity
(Unaudited, and amounts in thousands, except per share data)

	Series C Preferred Stock	Series D Preferred Stock	Common Stock Shares	Par Value	Additional Paid-In-Capital	Accumulated Other Comprehensive Income	Retained Earnings	Total	Comprehensive Income
Balance at December 31, 2005	**$ 151,981**	**$ 96,321**	**42,456**	**$ 425**	**$ 959,858**	**$ 15,316**	**$ 235,540**	**$ 1,459,441**	
Comprehensive Income:									
Net income							186,387	186,387	$ 186,387
Net unrealized loss on derivative instruments						(2,256)		(2,256)	(2,256)
SL Green s share of joint venture net unrealized gain on derivative instruments									1,945
Preferred dividends							(14,906)	(14,906)	
Redemption of units and DRIP proceeds			307	3	15,565			15,568	
Deferred compensation plan & stock award, net			94	1	380			381	
Amortization of deferred compensation plan					7,297			7,297	
Proceeds from stock options exercised			417	4	13,515			13,519	
Net proceeds from common stock offering			2,500	25	268,471			268.496	
Stock-based compensation fair value					3,405			3,405	
Cash distribution declared ($1.80 per common share of which none represented a return of capital for federal income tax purposes)							(79,277)	(79,277)	
	$ 151,981	$ 96,321	45,774	$ 458	$ 1,268,491	$ 13,060	$ 327,744	$ 1,858,055	$ 186,076

Balance at September 30, 2006

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

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SL Green Realty Corp.
Condensed Consolidated Statements of Cash Flows
(Unaudited, and amounts in thousands, except per share data)

	Nine months Ended September 30, 2006	2005
Operating Activities		
Net income	$ 186,387	$ 131,614
Adjustment to reconcile net income to net cash provided by operating activities:		
Non-cash adjustments related to income from discontinued operations	5,808	3,918
Depreciation and amortization	56,589	46,365
Gain on sale of discontinued operations	(94,410)	(33,856)
Equity in net income from unconsolidated joint ventures	(30,244)	(38,643)
Equity in net gain on sale of unconsolidated joint ventures	-	(11,550)
Distributions of cumulative earnings from unconsolidated joint ventures	31,110	34,969
Minority interest	7,092	4,979
Deferred rents receivable	(12,398)	(14,334)
Other non-cash adjustments	7,950	4,046
Changes in operating assets and liabilities:		
Restricted cash operations	(4,376)	(9,452)
Tenant and other receivables	(11,242)	(7,905)
Related party receivables	(1,856)	1,429
Deferred lease costs	(12,227)	(11,793)
Other assets	(3,155)	4
Accounts payable, accrued expenses and other liabilities	14,168	16,404
Deferred revenue and land lease payable	3,115	2,800
Net cash provided by operating activities	142,311	118,995
Investing Activities		
Acquisitions of real estate property	(466,762)	(422,149)
Additions to land, buildings and improvements	(38,405)	(30,524)
Escrowed cash capital improvements/acquisition deposits	(169,556)	7,679
Investments in unconsolidated joint ventures	(55,482)	(122,251)
Distributions in excess of cumulative earnings from unconsolidated joint ventures	39,102	33,669
Proceeds from disposition of real estate	161,036	59,673
Other investments	(15,288)	(27,207)
Structured finance and other investments net of repayments/participations	40,538	(43,534)
Net cash used in investing activities	(504,817)	(544,644)
Financing Activities		
Proceeds from mortgage notes payable	327,968	315,546
Repayments of mortgage notes payable	(2,927)	(63,382)
Proceeds from revolving credit facilities, and term loans	490,645	897,000
Repayments of revolving credit facilities and term loans	(522,645)	(672,900)
Net proceeds from sale of common stock	268,496	-
Proceeds from stock options exercised	13,519	15,788
Other financing activities	35,842	-
Dividends and distributions paid	(87,688)	(72,432)
Deferred loan costs and capitalized lease obligation	(8,364)	(15,573)
Net cash provided by financing activities	514,846	404,047
Net increase (decrease) in cash and cash equivalents	152,340	(21,602)
Cash and cash equivalents at beginning of period	24,104	35,795
Cash and cash equivalents at end of period	$ 176,444	$ 14,193

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

SL Green Realty Corp.
Notes to Condensed Consolidated Financial Statements
(Unaudited)
September 30, 2006

1. Organization and Basis of Presentation

SL Green Realty Corp., also referred to as the Company or SL Green, a Maryland corporation, and SL Green Operating Partnership, L.P., or the Operating Partnership, a Delaware limited partnership, were formed in June 1997 for the purpose of combining the commercial real estate business of S.L. Green Properties, Inc. and its affiliated partnerships and entities. The Operating Partnership received a contribution of interest in the real estate properties, as well as 95% of the economic interest in the management, leasing and construction companies which are referred to as the Service Corporation. The Company has qualified, and expects to qualify in the current fiscal year, as a real estate investment trust, or REIT, under the Internal Revenue Code of 1986, as amended, or the Code, and operates as a self-administered, self-managed REIT. A REIT is a legal entity that holds real estate interests and, through payments of dividends to stockholders, is permitted to reduce or avoid the payment of Federal income taxes at the corporate level. Unless the context requires otherwise, all references to we, our and us means the Company and all entities owned or controlled by the Company, including the Operating Partnership.

Substantially all of our assets are held by, and our operations are conducted through, the Operating Partnership. The Company is the sole managing general partner of the Operating Partnership. As of September 30, 2006, minority investors held, in the aggregate, a 4.6% limited partnership interest in our Operating Partnership.

As of September 30, 2006, our wholly-owned properties consisted of 20 commercial office properties encompassing approximately 9.6 million rentable square feet located primarily in midtown Manhattan, a borough of New York City, or Manhattan. As of September 30, 2006, the weighted average occupancy (total leased square feet divided by total available square feet) of the wholly-owned properties was 97.0%. Our portfolio also includes ownership interests in unconsolidated joint ventures, which own seven commercial office properties in Manhattan, encompassing approximately 8.8 million rentable square feet, and which had a weighted average occupancy of 95.2% as of September 30, 2006. We also own approximately 516,000 square feet of retail and development properties. In addition, we manage three office properties owned by third parties and affiliated companies encompassing approximately 1.0 million rentable square feet.

We also own approximately 25% of the outstanding common stock of Gramercy Capital Corp. (NYSE: GKK), or Gramercy. See Note 6.

Partnership Agreement

In accordance with the partnership agreement of the Operating Partnership, or the Operating Partnership Agreement, we allocate all distributions and profits and losses in proportion to the percentage ownership interests of the respective partners. As the managing general partner of the Operating Partnership, we are required to take such reasonable efforts, as determined by us in our sole discretion, to cause the Operating Partnership to distribute sufficient amounts to enable the payment of sufficient dividends by us to avoid any Federal income or excise tax at the Company level. Under the Operating Partnership Agreement each limited partner will have the right to redeem units of limited partnership interest for cash, or if we so elect, shares of our common stock on a one-for-one basis. In addition, we are prohibited from selling 673 First Avenue and 470 Park Avenue South before August 2009.

Basis of Quarterly Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for fair presentation have been included. The 2006 operating results for the period presented are not necessarily indicative of the results that may be expected for the year ending December 31, 2006. These financial statements should be read in conjunction with the financial statements and accompanying notes included in our annual report on Form 10-K for the year ended December 31, 2005.

The balance sheet at December 31, 2005 has been derived from the audited financial statements at that date but does not include all the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements.

2. Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include our accounts and those of our subsidiaries, which are wholly-owned or controlled by us or entities which are variable interest entities in which we are the primary beneficiary under the Financial Accounting Standards Board, or FASB, Interpretation No. 46, or FIN 46, Consolidation of Variable Interest Entities - an Interpretation of ARB No. 51, and FIN

46, Interpretation No. 46R. See Note 5, Note 6 and Note 7. Entities which we do not control and entities which are variable interest entities, but where we are not the primary beneficiary are accounted for under the equity method. We consolidate variable interest entities in which we are determined to be the primary beneficiary. All significant intercompany balances and transactions have been eliminated.

Investment in Commercial Real Estate Properties

In June 2005, the FASB ratified the consensus in EITF Issue No. 04-5, or EITF 04-5, Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights, which provides guidance in determining whether a general partner controls a limited partnership. EITF 04-5 states that the general partner in a limited partnership is presumed to control that limited partnership. The presumption may be overcome if the limited partners have either (1) the substantive ability to dissolve the limited partnership or otherwise remove the general partner without cause or (2) substantive participating rights, which provide the limited partners with the ability to effectively participate in significant decisions that would be expected to be made in the ordinary course of the limited partnership s business and thereby preclude the general partner from exercising unilateral control over the partnership. If the criteria in EITF 04-5 are met, the consolidation of existing joint ventures accounted for under the equity method may be required. Our adoption of EITF 04-5 did not have any effect on net income or stockholders equity.

In accordance with SFAS No. 141, Business Combinations, we allocate the purchase price of real estate to land and building and, if determined to be material, intangibles, such as the value of above, below and at-market leases and origination costs associated with the in-place leases. We depreciate the amount allocated to building and other intangible assets over their estimated useful lives, which generally range from three to 40 years. The values of the above and below market leases are amortized and recorded as either an increase (in the case of below market leases) or a decrease (in the case of above market leases) to rental income over the remaining term of the associated lease. The value associated with in-place leases and tenant relationships are amortized over the expected term of the relationship, which includes an estimated probability of the lease renewal, and its estimated term. If a tenant vacates its space prior to the contractual termination of the lease and no rental payments are being made on the lease, any unamortized balance of the related intangible will be written off. The tenant improvements and origination costs are amortized as an expense over the remaining life of the lease (or charged against earnings if the lease is terminated prior to its contractual expiration date). We assess fair value of the leases based on estimated cash flow projections that utilize appropriate discount and capitalization rates and available market information. Estimates of future cash flows are based on a number of factors including the historical operating results, known trends, and market/economic conditions that may affect the property.

As a result of our evaluations, under SFAS No. 141, of acquisitions made, we recognized an increase of approximately $591,000, $1.5 million, $237,000 and $793,000 in rental revenue for the three and nine months ended September 30, 2006 and 2005, respectively, for the amortization of below market leases and a reduction in lease origination costs, resulting from the reallocation of the purchase price of the applicable properties. We recognized a reduction in interest expense for the amortization of the above market rate mortgage of approximately $196,000, $577,000, $180,000 and $530,000 for the three and nine months ended September 30, 2006 and 2005, respectively.

Scheduled amortization on existing intangible liabilities on real estate investments is as follows (in thousands):

	Intangible Liabilities
2006	$ 850
2007	3,378
2008	3,374
2009	3,125
2010	2,626
Thereafter	5,210
	$ 18,563

Income Taxes

We are taxed as a REIT under Section 856(c) of the Code. As a REIT, we generally are not subject to Federal income tax. To maintain our qualification as a REIT, we must distribute at least 90% of our REIT taxable income to our stockholders and meet certain other requirements. If we fail to qualify as a REIT in any taxable year, we will be subject to Federal income tax on our taxable income at regular corporate rates. We may also be subject to certain state, local and franchise taxes. Under certain circumstances, Federal income and excise taxes may be due on our undistributed taxable income.

Pursuant to amendments to the Code that became effective January 1, 2001, we have elected or may elect to treat certain of our existing or newly created corporate subsidiaries as taxable REIT subsidiaries, or TRS. In general, a TRS of ours may perform non-customary services for our tenants, hold assets that we cannot hold directly and generally engage in any real estate or non-real estate related business. A TRS is subject to corporate Federal income tax. Our TRS s generate income, resulting in Federal income tax liability for these entities. Our TRS s paid approximately $1.3 million and $0.4 million in federal, state and local taxes during the nine months ended September 30, 2006 and 2005.

Stock-Based Employee Compensation Plans

We have a stock-based employee compensation plan, described more fully in Note 12. Prior to 2003, we accounted for this plan under Accounting Principles Board Opinion No. 25, or APB 25, Accounting for Stock Issued to Employees, and related interpretations. No stock-based employee compensation cost was reflected in net income prior to January 1, 2003, as all awards granted under such plan had an intrinsic value of zero on the date of grant. Effective January 1, 2003, we adopted the fair value recognition provisions of SFAS No. 123, Accounting for Stock-Based Compensation. Under the prospective method of adoption we selected under the provisions of SFAS No. 148, Accounting for Stock-Based Compensation - Transition and Disclosure, the recognition provisions applied to all employee awards granted, modified, or settled after January 1, 2003. In December 2004, the FASB revised SFAS No. 123 through the issuance of SFAS No. 123 Shared Based Payment, revised, or SFAS No. 123-R. SFAS No. 123-R became effective for us in the first quarter of 2006. SFAS No. 123-R, among other things, eliminates the alternative to use the intrinsic value method of accounting for stock-based compensation and requires entities to recognize the cost of employee services received in exchange for awards of equity instruments based on the grant-date fair value of those awards (with limited exceptions). The fair-value based method in SFAS No. 123-R is similar to the fair-value based method in SFAS No. 123 in most respects, subject to certain key differences. The adoption of SFAS No. 123-R did not have any impact on us, as we have applied the fair value method of accounting for stock-based compensation since January 1, 2003.

The Black-Scholes option-pricing model was developed for use in estimating the fair value of traded options, which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because our plan has characteristics significantly different from those of traded options and because changes in the subjective input assumptions can materially affect the fair value estimate, in our opinion, the existing models do not necessarily provide a reliable single measure of the fair value of our employee stock options.

Compensation cost for stock options, if any, is recognized ratably over the vesting period of the award. Our policy is to grant options with an exercise price equal to the quoted closing market price of our stock on the grant date. Awards of stock, restricted stock or employee loans to purchase stock, which may be forgiven over a period of time, are expensed as compensation on a current basis over the benefit period.

The fair value of each stock option granted is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions for grants in 2006 and 2005.

	2006	**2005**
Dividend yield	2.40 %	3.60 %
Expected life of option	5 years	6 years
Risk-free interest rate	4.80 %	3.70 %
Expected stock price volatility	16.61 %	17.23 %

The following table illustrates the effect on net income available to common stockholders and earnings per share if the fair value method had been applied to all outstanding and unvested stock options for the three and nine months ended September 30, 2006 and 2005 (in thousands, except per share amounts):

	Three Months Ended September 30,		**Nine months Ended September 30,**	
	2006	**2005**	**2006**	**2005**
Net income available to common stockholders	$ 118,689	$ 37,330	$ 171,481	$ 116,708
Deduct stock option expense-all awards	(670)	(416)	(2,117)	(1,164)
Add back stock option expense included in net income	416	155	1,367	384
Allocation of compensation expense to minority interest	31	23	104	66
Pro forma net income available to common stockholders	$ 118,466	$ 37,092	$ 170,835	$ 115,994
Basic earnings per common share-historical	$ 2.62	$ 0.89	$ 3.92	$ 2.80
Basic earnings per common share-pro forma	$ 2.62	$ 0.88	$ 3.91	$ 2.78
Diluted earnings per common share-historical	$ 2.53	$ 0.87	$ 3.78	$ 2.72

Diluted earnings per common share-pro forma