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CRESCENT REAL ESTATE EQUITIES CO  
Form 10-Q  
August 07, 2003

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

FOR QUARTER ENDED JUNE 30, 2003  
COMMISSION FILE NO. 1-13038

CRESCENT REAL ESTATE EQUITIES COMPANY

-----  
(Exact name of registrant as specified in its charter)

TEXAS

52-1862813

-----  
(State or other jurisdiction of  
incorporation or organization)

-----  
(I.R.S. Employer Identification Number)

777 Main Street, Suite 2100, Fort Worth, Texas 76102

-----  
(Address of principal executive offices) (Zip code)

Registrant's telephone number, including area code (817) 321-2100

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 twelve (12) months (or for such shorter period that the registrant was required to file such report) and (2) has been subject to such filing requirements for the past ninety (90) days.

YES  NO

Indicate by check mark whether the registrant is an accelerated filer (as defined in rule 12b-2 of the Exchange Act).

YES  NO

Number of shares outstanding of each of the registrant's classes of preferred and common shares, as of August 4, 2003.

Series A Convertible Cumulative Preferred Shares, par value \$0.01 per share:	10,800,000
Series B Cumulative Redeemable Preferred Shares, par value \$0.01 per share:	3,400,000
Common Shares, par value \$0.01 per share:	99,247,894

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FORM 10-Q  
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PART I

ITEM 1. FINANCIAL STATEMENTS

CRESCENT REAL ESTATE EQUITIES COMPANY  
CONSOLIDATED BALANCE SHEETS  
(in thousands, except share data)

JUNE 30,  
2003  
-----  
(UNAUDITED)

ASSETS:

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### Investments in real estate:

Land	\$ 318,404
Land held for investment or development	441,941
Building and improvements	2,933,203
Furniture, fixtures and equipment	120,693
Properties held for disposition, net	40,902
Less - accumulated depreciation	(794,568)

-----  
 Net investment in real estate \$ 3,060,575

Cash and cash equivalents	\$ 71,933
Restricted cash and cash equivalents	91,028
Accounts receivable, net	40,256
Deferred rent receivable	61,283
Investments in real estate mortgages and equity of unconsolidated companies	542,956
Notes receivable, net	107,556
Income tax asset-current and deferred, net	50,322
Other assets, net	182,311

-----  
 Total assets \$ 4,208,220  
 =====

### LIABILITIES:

Borrowings under Credit Facility	\$ 252,000
Notes payable	2,212,751
Accounts payable, accrued expenses and other liabilities	335,243

-----  
 Total liabilities \$ 2,799,994  
 -----

### COMMITMENTS AND CONTINGENCIES:

#### MINORITY INTERESTS:

Operating partnership, 8,874,402 and 8,878,342 units, at June 30, 2003 and December 31, 2002, respectively	\$ 115,270
Consolidated real estate partnerships	38,822

-----  
 Total minority interests \$ 154,092  
 -----

### SHAREHOLDERS' EQUITY:

Preferred shares, \$0.01 par value, authorized 100,000,000 shares:	
Series A Convertible Cumulative Preferred Shares, liquidation preference of \$25.00 per share, 10,800,000 shares issued and outstanding at June 30, 2003 and December 31, 2002	\$ 248,160
Series B Cumulative Preferred Shares liquidation preference of \$25.00 per share, 3,400,000 shares issued and outstanding at June 30, 2003 and December 31, 2002	81,923
Common shares, \$0.01 par value, authorized 250,000,000 shares, 124,294,941 and 124,280,867 shares issued and outstanding at June 30, 2003 and December 31, 2002, respectively	1,236
Additional paid-in capital	2,243,397
Deferred compensation on restricted shares	(5,253)
Accumulated deficit	(827,874)
Accumulated other comprehensive income	(27,241)

-----  
 Less - shares held in treasury, at cost, 25,125,649 and 25,068,759  
 common shares at June 30, 2003 and December 31, 2002, respectively (460,214)

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Total shareholders' equity	\$ 1,254,134
Total liabilities and shareholders' equity	\$ 4,208,220

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

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CRESCENT REAL ESTATE EQUITIES COMPANY  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(in thousands, except share data)  
(unaudited)

	FOR THE THREE ENDED JUN
	2003
REVENUE:	
Office Property	\$ 127,334
Resort/Hotel Property	51,632
Residential Development Property	54,207
Total Property revenue	233,173
EXPENSE:	
Office Property real estate taxes	18,475
Office Property operating expenses	43,977
Resort/Hotel Property expense	42,658
Residential Development Property expense	47,831
Total Property expense	152,941
Income from Property Operations	80,232
OTHER INCOME (EXPENSE):	
Income from investment land sales, net	1,627
Interest and other income	1,185
Corporate general and administrative	(6,185)
Interest expense	(43,073)
Amortization of deferred financing costs	(2,544)
Depreciation and amortization	(35,958)
Impairment and other charges related to real estate assets	--
Other expenses	(368)
Equity in net income (loss) of unconsolidated companies: Office Properties	1,864

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Resort/Hotel Properties	1,382
Residential Development Properties	1,540
Temperature-Controlled Logistics Properties	(406)
Other	214
	-----
Total Other Income (Expense)	(80,722)
	-----
(LOSS) INCOME FROM CONTINUING OPERATIONS BEFORE MINORITY INTERESTS AND INCOME TAXES	(490)
Minority interests	(1,846)
Income tax benefit (provision)	3,090
	-----
INCOME BEFORE DISCONTINUED OPERATIONS AND CUMULATIVE EFFECT OF A CHANGE IN ACCOUNTING PRINCIPLE	754
Discontinued operations - income (loss) on assets sold and held for sale	649
Discontinued operations - (loss) gain on assets sold and held for sale	(881)
Cumulative effect of a change in accounting principle	--
	-----
NET INCOME (LOSS)	522
Series A Preferred Share distributions	(4,556)
Series B Preferred Share distributions	(2,019)
	-----
NET (LOSS) INCOME AVAILABLE TO COMMON SHAREHOLDERS	\$ (6,053)
	=====
BASIC EARNINGS PER SHARE DATA:	
Net (loss) income before discontinued operations and cumulative effect of a change in accounting principle	\$ (0.06)
Discontinued operations - income (loss) on assets sold and held for sale	0.01
Discontinued operations - (loss) gain on assets sold and held for sale	(0.01)
Cumulative effect of a change in accounting principle	--
	-----
Net (loss) income - basic	\$ (0.06)
	=====
DILUTED EARNINGS PER SHARE DATA:	
Net (loss) income before discontinued operations and cumulative effect of a change in accounting principle	\$ (0.06)
Discontinued operations - income (loss) on assets sold and held for sale	0.01
Discontinued operations - (loss) gain on assets sold and held for sale	(0.01)
Cumulative effect of a change in accounting principle	--
	-----
Net (loss) income - diluted	\$ (0.06)
	=====

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

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CRESCENT REAL ESTATE EQUITIES COMPANY  
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY  
(dollars in thousands)  
(unaudited)

	Series A Preferred Shares		Series B Preferred Shares	
	Shares	Net Value	Shares	Net Value
SHAREHOLDERS' EQUITY, December 31, 2002	10,800,000	\$ 248,160	3,400,000	\$ 81,000
Issuance of Common Shares	--	--	--	--
Accretion of Discount on Employee Stock Option Notes	--	--	--	--
Issuance of Shares in Exchange for Operating Partnership Units	--	--	--	--
Share Purchase under Compensation Plan	--	--	--	--
Dividends Paid	--	--	--	--
Net (Loss) Income	--	--	--	--
Unrealized and Realized Gain (Loss) on Marketable Securities	--	--	--	--
Unrealized Net Loss on Cash Flow Hedges	--	--	--	--
SHAREHOLDERS' EQUITY, June 30, 2003	10,800,000	\$ 248,160	3,400,000	\$ 81,000

	Common Shares		Additional Paid-in Capital	Def Compen on Res Sh
	Shares	Par Value		
SHAREHOLDERS' EQUITY, December 31, 2002	124,280,867	\$ 1,236	\$ 2,243,419	\$ ( )
Issuance of Common Shares	6,194	--	96	--
Accretion of Discount on Employee Stock Option Notes	--	--	(126)	--
Issuance of Shares in Exchange for Operating Partnership Units	7,880	--	8	--
Share Purchase under Compensation Plan	--	--	--	--
Dividends Paid	--	--	--	--
Net (Loss) Income	--	--	--	--
Unrealized and Realized Gain (Loss) on Marketable Securities	--	--	--	--

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Unrealized Net Loss on Cash Flow Hedges	--	--	--
SHAREHOLDERS' EQUITY, June 30, 2003	----- 124,294,941 =====	\$ 1,236 ----- =====	\$ 2,243,397 ----- =====
	Accumulated Other Comprehensive Income -----	Total -----	
SHAREHOLDERS' EQUITY, December 31, 2002	\$ (27,252)	\$ 1,354,813	
Issuance of Common Shares	--	96	
Accretion of Discount on Employee Stock Option Notes	--	(126)	
Issuance of Shares in Exchange for Operating Partnership Units	--	8	
Share Purchase under Compensation Plan	--	(854)	
Dividends Paid	--	(74,431)	
Net (Loss) Income	--	(25,383)	
Unrealized and Realized Gain (Loss) on Marketable Securities	383	383	
Unrealized Net Loss on Cash Flow Hedges	(372)	(372)	
SHAREHOLDERS' EQUITY, June 30, 2003	----- \$ (27,241) =====	----- \$ 1,254,134 =====	

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

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CRESCENT REAL ESTATE EQUITIES COMPANY  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(dollars in thousands)  
(unaudited)

CASH FLOWS FROM OPERATING ACTIVITIES:

Net (loss) income

Adjustments to reconcile net (loss) income to net cash provided by operating activities:

Depreciation and amortization

Residential Development cost of sales

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Residential Development capital expenditures  
Discontinued operations  
Impairment and other charges related to real estate assets  
Income from investment in land sales, net  
Minority interests  
Cumulative effect of a change in accounting principle  
Non-cash compensation  
Distributions received in excess of earnings from unconsolidated companies:  
    Office Properties  
    Other  
Equity in (earnings) loss net of distributions received from unconsolidated companies:  
    Office Properties  
    Resort/Hotel Properties  
    Residential Development Properties  
    Temperature-Controlled Logistics Properties  
    Other  
Change in assets and liabilities, net of effects of DBL consolidation/COPI transaction:  
    Restricted cash and cash equivalents  
    Accounts receivable  
    Deferred rent receivable  
    Income tax asset - current and deferred  
    Other assets  
    Accounts payable, accrued expenses and other liabilities  
  
Net cash provided by operating activities

### CASH FLOWS FROM INVESTING ACTIVITIES:

Net cash impact of DBL consolidation/COPI transaction  
Proceeds from property sales  
Acquisition of rental properties  
Development of investment properties  
Property improvements - Office Properties  
Property improvements - Resort/Hotel Properties  
Tenant improvement and leasing costs - Office Properties  
Residential Development Properties Investments  
(Increase) decrease in restricted cash and cash equivalents  
Return of investment in unconsolidated companies:  
    Office Properties  
    Residential Development Properties  
    Temperature-Controlled Logistics Properties  
    Other  
Investment in unconsolidated companies:  
    Office Properties  
    Residential Development Properties  
    Temperature-Controlled Logistics Properties  
    Other  
Decrease (increase) in notes receivable  
  
Net cash used in investing activities

### CASH FLOWS FROM FINANCING ACTIVITIES:

Debt financing costs  
Borrowings under Credit Facility  
Payments under Credit Facility  
Notes payable proceeds  
Notes payable payments  
Residential Development Properties notes payable borrowings  
Residential Development Properties notes payable payments  
Purchase of GMAC preferred interest



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Capital distributions - joint venture partner  
Capital distributions - joint venture preferred equity  
Proceeds from exercise of share options  
Treasury shares purchase under compensation plan  
Common share repurchases held in Treasury  
Issuance of preferred shares - Series A  
Issuance of preferred shares - Series B  
Series A Preferred Share distributions  
Series B Preferred Share distributions  
Dividends and unitholder distributions

Net cash used in financing activities

(DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS

CASH AND CASH EQUIVALENTS,  
Beginning of period

CASH AND CASH EQUIVALENTS,  
End of Period

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

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### CRESCENT REAL ESTATE EQUITIES COMPANY NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### 1. ORGANIZATION AND BASIS OF PRESENTATION

Crescent Real Estate Equities Company ("Crescent Equities") operates as a real estate investment trust for federal income tax purposes (a "REIT") and, together with its subsidiaries, provides management, leasing and development services for some of its properties.

The term "Company" includes, unless the context otherwise indicates, Crescent Equities, a Texas real estate investment trust, and all of its direct and indirect subsidiaries.

The direct and indirect subsidiaries of Crescent Equities at June 30, 2003 included:

- o CRESCENT REAL ESTATE EQUITIES LIMITED PARTNERSHIP  
The "Operating Partnership."
- o CRESCENT REAL ESTATE EQUITIES, LTD.  
The "General Partner" of the Operating Partnership.
- o SUBSIDIARIES OF THE OPERATING PARTNERSHIP AND THE GENERAL PARTNER

Crescent Equities conducts all of its business through the Operating Partnership and its other subsidiaries. The Company is structured to facilitate

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and maintain the qualification of Crescent Equities as a REIT.

The following table shows the consolidated subsidiaries of the Company that owned or had an interest in real estate assets and the real estate assets that each subsidiary owned or had an interest in as of June 30, 2003.

Operating Partnership	Wholly-owned assets - The Avallon IV, Chancellor Park, Datran Center properties), Houston Center (three office properties and the Houston Center. These properties are included in the Company's Office Segment.  Joint Venture assets, consolidated - 301 Congress Avenue (50% interest), Woodlands Office Properties (85.6% interest) (four office properties), Sonoma Mission Inn & Spa (80.1% interest), included in the Company's Office Segment.  Equity Investments, unconsolidated - Bank One Center (50% interest), Three Westlake Park (20% interest), Four Westlake Park (20% interest), Center (40% interest), 5 Houston Center (25% interest) and Five Points (25% interest). These properties are included in the Company's Office Segment. Palm Beach (50% interest), included in the Company's Resort/Hotel Segment. 88 temperature-controlled logistics properties (40% interest in 88 properties), included in the Company's Temperature-Controlled Logistics Segment.
Crescent Real Estate Funding I, L.P. ("Funding I")	Wholly-owned assets - The Aberdeen, The Avallon I, II & III, Carter Center, Citadel, The Crescent Atrium, The Crescent Office Towers, Regency Park Commons and 125 E. John Carpenter Freeway. These properties are included in the Company's Office Segment.
Crescent Real Estate Funding II, L.P. ("Funding II")	Wholly-owned assets - Albuquerque Plaza, Barton Oaks Plaza One, Briarwood Research Center, Las Colinas Plaza, Liberty Plaza I & II, MacArthur Park, Ptarmigan Place, Stanford Corporate Centre, Two Renaissance Square Central. These properties are included in the Company's Office Segment. Regency Albuquerque and the Park Hyatt Beaver Creek Resort & Spa. These properties are included in the Company's Resort/Hotel Segment.
Crescent Real Estate Funding III, IV and V, L.P. ("Funding III, IV and V") (2)	Wholly-owned assets - Greenway Plaza Office Properties (ten office properties) are included in the Company's Office Segment. Renaissance Palm Beach included in the Company's Resort/Hotel Segment.
Crescent Real Estate Funding VI, L.P. ("Funding VI")	Wholly-owned asset - Canyon Ranch - Lenox, included in the Company's Office Segment.
Crescent Real Estate Funding VII, L.P. ("Funding VII")	Wholly-owned assets - Five behavioral healthcare properties.

Crescent Real Estate Wholly-owned assets - The Addison, Addison Tower, Austin Centre, The

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Funding VIII, L.P. ("Funding VIII")	Bank Plaza, Greenway I and IA (two office properties), Greenway II, Plaza, Palisades Central I, Palisades Central II, Stemmons Place, T Center(3), 3333 Lee Parkway, 1800 West Loop South, 5050 Quorum, 44 Madison. These properties are included in the Company's Office Seg Ranch - Tucson, Omni Austin Hotel, and Ventana Inn & Spa, all of wh the Company's Resort/Hotel Segment.
Crescent 707 17th Street, L.L.C.	Wholly-owned assets - 707 17th Street, included in the Company's Of The Denver Marriott City Center, included in the Company's Resort/H
Crescent Real Estate Funding X, L.P. ("Funding X")	Wholly-owned assets - Fountain Place and Post Oak Central (three of all of which are included in the Company's Office Segment.
Crescent Spectrum Center, L.P.(4)	Wholly-owned asset - Spectrum Center, included in the Company's Off
Mira Vista Development Corp. ("MVDC")	Equity Investments, consolidated - Mira Vista (98% interest), inclu Residential Development Segment.
Houston Area Development Corp. ("HADC")	Equity Investments, consolidated - Falcon Point (98% interest), Fal interest) and Spring Lakes (98% interest). These properties are in Company's Residential Development Segment.
Desert Mountain Development Corporation ("DMDC")	Equity Investments, consolidated - Desert Mountain (93% interest), Company's Residential Development Segment.
The Woodlands Land Company ("TWLC")	Equity Investments, unconsolidated - The Woodlands (42.5% interest) Company's Residential Development Segment.
Crescent Resort Development Inc. ("CRDI")	Equity Investments, consolidated - Eagle Ranch (60% interest), Main (30% interest), Main Street Station (30% interest), Main Street Sta (30% interest), Riverbend (60% interest), Park Place at Riverfront Tower at Riverfront (64% interest), Promenade Lofts at Riverfront ( Creekside at Riverfront (64% interest), Cresta (60% interest), Snow interest), Horizon Pass Lodge (64% interest), One Vendue Range (62% Greenwood (71.2% interest), Tahoe Mountain Resorts (57% - 71.2% int properties are included in the Company's Residential Development Se
Crescent TRS Holdings Corp.	Equity Investment, unconsolidated - Blue River Land Company, L.L.C. interest), included in the Company's Residential Development Segmen
Crescent TRS Holdings Corp.	Equity Investments, unconsolidated - two quarries (56% interest). included in the Company's Temperature-Controlled Logistics Segment.

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- (1) During the second quarter of 2003, The Park Shops was renamed the Houston Center Shops.
- (2) Funding III owns nine of the ten office properties in the Greenway Plaza office portfolio and the Renaissance Houston Hotel; Funding IV owns the central heated and chilled water plant building located at Greenway Plaza; and Funding V owns 9 Greenway, the remaining office property in the Greenway Plaza office portfolio.
- (3) The Company owns the principal economic interest in Trammell Crow Center through its ownership of fee simple title to the property (subject to a ground lease and a leasehold estate regarding the

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building) and two mortgage notes encumbering the leasehold interests in the land and the building.

- (4) In May 2003, Crescent Spectrum Center, L.P. exercised its option to acquire the Spectrum Center property in exchange for the mortgage on the property.
- (5) Distributions are made to partners based on specified payout percentages. During the six months ended June 30, 2003, the Company's payout percentage and economic interest were 52.5%.

See Note 7, "Investments in Real Estate Mortgages and Equity of Unconsolidated Companies," for a table that lists the Company's ownership in significant unconsolidated joint ventures and equity investments as of June 30, 2003.

See Note 8, "Notes Payable and Borrowings Under Credit Facility," for a list of certain other subsidiaries of the Company, all of which are consolidated in the Company's financial statements and were formed primarily for the purpose of obtaining secured debt or joint venture financing.

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### CRESCENT REAL ESTATE EQUITIES COMPANY NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### SEGMENTS

The assets and operations of the Company were divided into four investment segments at June 30, 2003, as follows:

- o Office Segment;
- o Resort/Hotel Segment;
- o Residential Development Segment; and
- o Temperature-Controlled Logistics Segment.

Within these segments, the Company owned in whole or in part the following real estate assets (the "Properties") as of June 30, 2003:

- o OFFICE SEGMENT consisted of 73 office properties, including three retail properties (collectively referred to as the "Office Properties"), located in 25 metropolitan submarkets in six states, with an aggregate of approximately 29.5 million net rentable square feet. 61 of the Office Properties are wholly-owned and 12 are owned through joint ventures, five of which are consolidated and seven of which are unconsolidated.
- o RESORT/HOTEL SEGMENT consisted of six luxury and destination fitness resorts and spas with a total of 1,306 rooms/guest nights and four upscale business-class hotel properties with a total of 1,771 rooms (collectively referred to as the "Resort/Hotel Properties"). Eight of the Resort/Hotel Properties are wholly-owned, one is owned through a joint venture that is consolidated, and one is owned through a joint venture that is unconsolidated.

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- o RESIDENTIAL DEVELOPMENT SEGMENT consisted of the Company's ownership of real estate mortgages and voting and non-voting common stock representing interests of 98% to 100% in five residential development corporations (collectively referred to as the "Residential Development Corporations"), which in turn, through partnership arrangements, owned in whole or in part 23 upscale residential development properties, 21 of which are consolidated and two of which are unconsolidated (collectively referred to as the "Residential Development Properties").
  
- o TEMPERATURE-CONTROLLED LOGISTICS SEGMENT consisted of the Company's 40% interest in Vornado Crescent Portland Partnership (the "Temperature-Controlled Logistics Partnership") and a 56% interest in the Vornado Crescent Carthage and KC Quarry L.L.C. The Temperature-Controlled Logistics Partnership owns all of the common stock, representing substantially all of the economic interest, of AmeriCold Corporation (the "Temperature-Controlled Logistics Corporation"), a REIT. As of June 30, 2003, the Temperature-Controlled Logistics Corporation directly or indirectly owned 88 temperature-controlled logistics properties (collectively referred to as the "Temperature-Controlled Logistics Properties") with an aggregate of approximately 441.5 million cubic feet (17.5 million square feet) of warehouse space. As of June 30, 2003, the Vornado Crescent Carthage and KC Quarry, L.L.C. owned two quarries and the related land. The Company accounts for its interests in the Temperature-Controlled Logistics Partnership and in the Vornado Crescent Carthage and KC Quarry L.L.C. as unconsolidated equity investments.

See Note 3, "Segment Reporting," for a table showing total revenues, operating expenses, equity in net income (loss) of unconsolidated companies and funds from operations for each of these investment segments for the three and six months ended June 30, 2003 and 2002, and total assets, consolidated property level financing, consolidated other liabilities, and minority interests for each of these investment segments at June 30, 2003 and December 31, 2002.

For purposes of segment reporting as defined in Statement of Financial Accounting Standards ("SFAS") No. 131, "Disclosures About Segments of an Enterprise and Related Information," and this Quarterly Report on Form 10-Q, the Resort/Hotel Properties, the Residential Development Properties and the Temperature-Controlled Logistics Properties are considered three separate reportable segments, as described above. However, for purposes of investor communications, the Company classifies its luxury and destination fitness resorts and spas and Residential Development Properties as a single group referred to as the "Resort and Residential Development Sector" due to the similar characteristics of targeted customers. This group does not contain the four business-class hotel properties. Instead, for investor communications, the four business-class hotel properties are classified with the Temperature-Controlled Logistics Properties as the Company's "Investment Sector."

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The accompanying unaudited financial statements have been prepared in conformity with generally accepted accounting principles in the United States ("GAAP") for interim financial information, as well as in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, the information and footnotes required by GAAP for complete financial statements are not included. In management's opinion, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation of the unaudited interim financial statements are included. Operating results for interim periods reflected do not necessarily indicate the results that may be expected for a full fiscal year. You should read these financial statements in conjunction with the financial statements and the accompanying notes included in the Company's Form 10-K for the year ended December 31, 2002.

Certain amounts in prior period financial statements have been reclassified to conform to current period presentation.

### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

This section should be read in conjunction with the more detailed information regarding the Company's significant accounting policies contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2002.

#### ADOPTION OF NEW ACCOUNTING STANDARDS

SFAS NO. 145. In April 2002, the Financial Accounting Standards Board ("FASB") issued SFAS No. 145, "Rescission of FASB Statements 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections." SFAS No. 145 requires the reporting of gains and losses from early extinguishment of debt be included in the determination of net income unless criteria in Accounting Principles Board Opinion No. 30, "Reporting the Results of Operations," which allows for extraordinary item classification, are met. The provisions of this Statement related to the rescission of Statement No. 4 are to be applied in fiscal years beginning after May 15, 2002. The Company adopted this Statement for fiscal 2003 and expects no impact in 2003 beyond the classification of costs related to early extinguishments of debt, which were shown in the Company's 2001 Consolidated Statements of Operations as an extraordinary item.

SFAS NOS. 148 AND 123. In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure," effective for fiscal years ending after December 15, 2002, to amend the transition and disclosure provisions of SFAS No. 123, "Accounting for Stock-Based Compensation." In addition to the prospective transition method of accounting for Stock-Based Employee Compensation using the fair value method provided in SFAS No. 123, SFAS No. 148 permits two additional transition methods, both of which avoid the ramp-up effect arising from prospective application of the fair value method. The Retroactive Restatement Method requires companies to restate all periods presented to reflect the Stock-Based Employee Compensation under the fair value method for all employee awards granted, modified, or settled in fiscal years beginning after December 15, 1994. The Modified Prospective Method requires companies to recognize Stock-Based Employee Compensation from the beginning of the fiscal year in which the recognition provisions are first applied as if the fair value method in SFAS No. 123 had been used to account for employee awards granted, modified, or settled in fiscal years beginning after December 15, 1994. Also, in the absence of a single accounting method for Stock-Based Employee Compensation, SFAS No. 148 expands disclosure requirements from those existing in SFAS No. 123, and requires disclosure of whether, when, and how an entity adopted the preferable, fair value method of accounting.

Effective January 1, 2003, the Company adopted the fair value expense recognition provisions of SFAS No. 123 on a prospective basis as permitted, which requires that the value of stock options at the date of grant be amortized

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ratably into expense over the appropriate vesting period. During the six months ended June 30, 2003, the Company granted stock options and recognized compensation expense that was not significant to its results of operations. With respect to the Company's stock options which were granted prior to 2003, the Company accounted for stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and related Interpretations ("APB No. 25"). Under APB No. 25, compensation cost is measured as the excess, if any, of the quoted market price of the Company's common shares at the date of grant over the exercise price of the option granted. Compensation cost for stock options, if any, is recognized ratably over the vesting period. During the six months ended June 30, 2003, no compensation cost was recognized for grants of stock options made prior to 2003 under the Company stock option plans because the Company's policy is to grant stock options with an exercise price equal to the quoted closing market price of the Company's common shares on the grant date. Had compensation cost for the Plans been determined based on the

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### CRESCENT REAL ESTATE EQUITIES COMPANY NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

fair value at the grant dates for awards under the Plans consistent with SFAS No. 123, the Company's net (loss) income and (loss) earnings per share would have been reduced to the following pro forma amounts:

(in thousands, except per share amounts)	FOR THE THREE MONTHS ENDED JUNE 30,		FOR THE SIX
	2003	2002	2003
Net (loss) income available to common shareholders, as reported	\$ (6,053)	\$ 6,727	\$ (25,383)
Deduct: total stock-based employee compensation expense determined under fair value based method for all awards	(765)	(1,093)	(1,602)
Pro forma net (loss) income	\$ (6,818)	\$ 5,634	\$ (26,985)
(Loss) earnings per share:			
Basic - as reported	\$ (0.06)	\$ 0.07	\$ (0.26)
Basic - pro forma	\$ (0.07)	\$ 0.05	\$ (0.27)
Diluted - as reported	\$ (0.06)	\$ 0.07	\$ (0.26)
Diluted - pro forma	\$ (0.07)	\$ 0.05	\$ (0.27)

SFAS NO. 149. In April 2003, the FASB issued SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." SFAS No. 149 amends and clarifies the financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." In general, SFAS No. 149 is effective for contracts entered into or modified after June 30, 2003 and for hedging relationships designated after June 30, 2003. The adoption of this statement is not expected to have a material impact, if any, on the Company's financial condition or its results of operations.

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SFAS NO. 150. In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." SFAS No. 150 establishes standards for how an issuer should classify and measure certain financial instruments that have both liability and equity characteristics. The provisions of this Statement are to be applied to financial instruments entered into or modified after May 31, 2003 and to existing instruments as of the beginning of the first interim financial reporting period after June 15, 2003. The adoption of this statement is not expected to have a material impact, if any, on the Company's financial condition or its results of operations.

FASB INTERPRETATION 45. In November 2002, the FASB issued Interpretation 45, "Guarantors' Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" ("FIN 45"), which elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued, and liability-recognition requirements for a guarantor of certain types of debt. The new guidance requires a guarantor to recognize a liability at the inception of a guarantee which is covered by the new requirements whether or not payment is probable, creating the new concept of a "stand-ready" obligation. Initial recognition and initial measurement provisions are applicable on a prospective basis to guarantees issued or modified after December 31, 2002. See Note 10, "Commitments and Contingencies," for disclosure of the Company's guarantees at June 30, 2003. The Company adopted FIN 45 effective January 1, 2003.

FASB INTERPRETATION 46. On January 15, 2003, the FASB approved the issuance of Interpretation 46, "Consolidation of Variable Interest Entities" ("FIN 46"), an interpretation of Accounting Research Bulletin No. 51, "Consolidated Financial Statements." Under FIN 46, consolidation requirements are effective immediately for new Variable Interest Entities ("VIEs") created after January 31, 2003. The consolidation requirements apply to existing VIEs in the first fiscal year or interim period beginning after June 15, 2003. VIEs are generally a legal structure used for business enterprises that either do not have equity investors with voting rights, or have equity investors that do not provide sufficient financial resources for the entity to support its activities. The objective of the new guidance is to improve reporting by addressing when a company should include in its financial statements the assets, liabilities and activities of another entity such as a VIE. FIN 46 requires a VIE to be consolidated by a company if the company is subject to a majority of the risk of loss from the VIE's activities or entitled to receive a majority of the entity's residual returns or both. FIN 46 also requires disclosures about VIEs that the company is not required to consolidate but in which it has a significant variable interest. Certain of the

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### CRESCENT REAL ESTATE EQUITIES COMPANY NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

disclosure requirements apply in all financial statements issued after January 31, 2003, regardless of when the VIE was established. These disclosure requirements are as follows: (a) the nature, purpose, size, and activities of the variable interest entity; and, (b) the enterprise's maximum exposure to loss as a result of its involvement with the VIE. FIN 46 may be applied prospectively with a cumulative effect adjustment as of the date on which it is first applied or by restating previously issued financial statements for one or more years with a cumulative effect adjustment as of the beginning of the first year restated. The Company is assessing the impact of this Interpretation, if any, on



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its existing entities and does not believe the impact will be significant on its liquidity, financial position, and results of operations. The Company did not create any VIEs subsequent to January 31, 2003.

### SIGNIFICANT ACCOUNTING POLICIES

**EARNINGS PER SHARE.** SFAS No. 128, "Earnings Per Share," ("EPS") specifies the computation, presentation and disclosure requirements for earnings per share.

Basic EPS is computed by dividing net income available to common stockholders by the weighted average number of shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock, where such exercise or conversion would result in a lower EPS amount. The Company presents both basic and diluted earnings per share.

The following tables present reconciliations for the three and six months ended June 30, 2003 and 2002 of basic and diluted earnings per share from "Income before discontinued operations and cumulative effect of a change in accounting principle" to "Net (loss) income available to common shareholders." The table also includes weighted average shares on a basic and diluted basis.

(in thousands, except per share amounts)	FOR THE THREE MONTHS EN			
	2003			
	Income (Loss)	Wtd. Avg. Shares	Per Share Amount	I (
BASIC EPS -				
Income before discontinued operations	\$ 754	99,170		\$
Series A Preferred Share distributions	(4,556)			
Series B Preferred Share distributions	(2,019)			
Net (loss) income available to common shareholders before discontinued operations	\$ (5,821)	99,170	(0.06)	\$
Discontinued operations - income (loss) on assets sold and held for sale	649		0.01	
Discontinued operations- (loss) gain on assets sold and held for sale	(881)		(0.01)	
Net (loss) income available to common shareholders	\$ (6,053)	99,170	(0.06)	\$

(in thousands, except per share amounts)	FOR THE THREE MONTHS EN			
	2003			
	Income (Loss)	Wtd. Avg. Shares	Per Share Amount	I (
DILUTED EPS -				

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Income before discontinued operations	\$ 754	99,170		\$
Series A Preferred Share distributions	(4,556)			
Series B Preferred Share distributions	(2,019)			
	-----	-----	-----	-----
Effect of dilutive securities				
Additional common shares relating to share and unit options		13		
Net (loss) income available to common shareholders before discontinued operations	\$ (5,821)	99,183	(0.06)	\$
Discontinued operations - income (loss) on assets sold and held for sale	649		0.01	
Discontinued operations - (loss) gain on assets sold and held for sale	(881)		(0.01)	
	-----	-----	-----	-----
Net (loss) income available to common shareholders	\$ (6,053)	99,183	(0.06)	\$
	=====	=====	=====	=====

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CRESCENT REAL ESTATE EQUITIES COMPANY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

	FOR THE SIX MONTHS EN			
	-----			
	2003			
	Income	Wtd. Avg.	Per Share	I
(in thousands, except per share amounts)	(Loss)	Shares	Amount	(
	-----	-----	-----	-----
BASIC EPS -				
Income before discontinued operations and cumulative effect of a change in accounting principle	\$ 1,738	99,194		\$
Series A Preferred Share distributions	(9,112)			
Series B Preferred Share distributions	(4,038)			
	-----	-----	-----	-----
Net (loss) income available to common shareholders before discontinued operations and cumulative effect of a change in accounting principle	\$ (11,412)	99,194	(0.12)	\$
Discontinued operations - income on assets sold and held for sale	624		0.01	
Discontinued operations - (loss) gain on assets sold and held for sale	(14,595)		(0.15)	
Cumulative effect of a change in accounting principle	--		--	
	-----	-----	-----	-----
Net (loss) income available to common shareholders	\$ (25,383)	99,194	(0.26)	\$
	=====	=====	=====	=====

FOR THE SIX MONTHS EN

-----  
2003  
-----

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(in thousands, except per share amounts)	Income (Loss)	Wtd. Avg. Shares	Per Share Amount	I (
-----	-----	-----	-----	-----
DILUTED EPS -				
Income before discontinued operations and cumulative effect of a change in accounting principle	\$ 1,738	99,194		\$
Series A Preferred Share distributions	(9,112)			
Series B Preferred Share distributions	(4,038)			
	-----	-----	-----	-----
Effect of dilutive securities				
Additional common shares relating to share and unit options		7		
Net (loss) income available to common shareholders before discontinued operations and cumulative effect of a change in accounting principle	\$ (11,412)	99,201	(0.12)	\$
Discontinued operations - income on assets sold and held for sale	624		0.01	
Discontinued operations - (loss) gain on assets sold and held for sale	(14,595)		(0.15)	
Cumulative effect of a change in accounting principle	--		--	
	-----	-----	-----	-----
Net (loss) income available to common shareholders	\$ (25,383)	99,201	(0.26)	\$
	=====	=====	=====	=====

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CRESCENT REAL ESTATE EQUITIES COMPANY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

This table presents supplemental cash flows disclosures for the six months ended June 30, 2003 and 2002.

SUPPLEMENTAL DISCLOSURE TO STATEMENTS OF CASH FLOWS

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:  (in thousands) -----	FOR THE SIX MONTHS ENDE	
	2003 -----	2002 -----
Interest paid on debt	\$ 76,240	\$ 71,
Interest capitalized - Office Properties	--	
Interest capitalized - Residential Development Properties	8,297	5,
Additional interest paid in conjunction with cash flow hedges	10,114	12,
	-----	-----
Total interest paid	\$ 94,651	\$ 88,
	=====	=====
Cash paid for income taxes	\$ 1,640	\$ 11,
	=====	=====

SUPPLEMENTAL SCHEDULE OF NON CASH INVESTING AND FINANCING  
ACTIVITIES:

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Conversion of Operating Partnership units to common shares with resulting reduction in minority interest and increases in common shares and additional paid-in capital	\$	8	\$
Unrealized and realized gain (loss) on marketable securities		383	(1,
Impairment and other charges related to real estate assets		18,018	3,
Adjustment of cash flow hedge to fair value		(487)	6,

### SUPPLEMENTAL SCHEDULE OF 2003 CONSOLIDATION OF DBL, MVDC AND HADC AND THE 2002 TRANSFER OF ASSETS AND ASSUMPTION OF LIABILITIES PURSUANT TO THE FEBRUARY 14, 2002 AGREEMENT WITH COPI:

Net investment in real estate	\$	(9,692)	\$ (570,
Restricted cash and cash equivalents		--	(3,
Accounts receivable, net		(3,057)	(23,
Investments in real estate mortgages and equity of unconsolidated companies		13,552	309,
Notes receivable, net		(25)	29,
Income tax asset - current and deferred, net		(3,564)	(21,
Other assets, net		(820)	(63,
Notes payable		312	129,
Accounts payable, accrued expenses and other liabilities		12,696	201,
Minority interest - consolidated real estate partnerships		1,972	51,
		-----	-----
Increase in cash	\$	11,374	\$ 38,
		=====	=====

### 3. SEGMENT REPORTING

For purposes of segment reporting as defined in SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information," the Company currently has four major investment segments based on property type: the Office Segment; the Resort/Hotel Segment; the Residential Development Segment; and the Temperature-Controlled Logistics Segment. Management utilizes this segment structure for making operating decisions and assessing performance.

The Company uses funds from operations ("FFO") as the measure of segment profit or loss. FFO, as used in this document, is based on the definition adopted by the Board of Governors of the National Association of Real Estate Investment Trusts ("NAREIT") and means:

- o Net Income (Loss) - determined in conformity with GAAP;
- o excluding gains (losses) from sales of depreciable operating property;
- o excluding extraordinary items (as defined by GAAP);
- o including depreciation and amortization of real estate assets; and
- o after adjusting for unconsolidated partnerships and joint ventures.

NAREIT developed FFO as a relative measure of performance of an equity REIT to recognize that income-producing real estate historically has not depreciated on the basis determined under GAAP. The Company considers FFO an appropriate measure of performance for an equity REIT and for its investment segments. However, FFO should not be considered as an alternative to net income determined in accordance with GAAP as an indication of the Company's operating performance.

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CRESCENT REAL ESTATE EQUITIES COMPANY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The Company's measure of FFO may not be comparable to similarly titled measures of other REITs if those REITs apply the definition of FFO in a different manner than the Company.

Selected financial information related to each segment for the three and six months ended June 30, 2003 and 2002, and total assets, consolidated property level financing, consolidated other liabilities, and minority interests for each of the segments at June 30, 2003 and December 31, 2002, are presented below:

SELECTED FINANCIAL INFORMATION:		FOR THE THREE MONTHS ENDED JUNE 30, 2003			
(in thousands)	OFFICE SEGMENT	RESORT/HOTEL SEGMENT	RESIDENTIAL DEVELOPMENT SEGMENT	TEMPERATURE- CONTROLLED LOGISTICS SEGMENT	CO AN
Property revenues	\$127,334 (1)	\$ 51,632	\$ 54,207	\$ --	\$
Other income	--	--	--	--	
Total revenue	\$127,334	\$ 51,632	\$ 54,207	\$ --	\$
Property operating expenses	\$ 62,452	\$ 42,658	\$ 47,831	\$ --	\$
Other operating expenses	--	--	--	--	
Total expenses	\$ 62,452	\$ 42,658	\$ 47,831	\$ --	\$
Equity in net income (loss) of unconsolidated companies	\$ 1,864	\$ 1,382	\$ 1,540	\$ (406)	\$
Funds from operations	\$ 70,011	\$ 12,356	\$ 5,705	\$ 5,079	\$ (

SELECTED FINANCIAL INFORMATION:		FOR THE THREE MONTHS ENDED JUNE 30, 2002			
(in thousands)	OFFICE SEGMENT	RESORT/HOTEL SEGMENT	RESIDENTIAL DEVELOPMENT SEGMENT	TEMPERATURE- CONTROLLED LOGISTICS SEGMENT	CO AN
Property revenues	\$138,378 (1)	\$ 53,523	\$ 83,480	\$ --	\$
Other income	--	--	--	--	
Total revenue	\$138,378	\$ 53,523	\$ 83,480	\$ --	\$
Property operating expenses	\$ 60,951	\$ 42,212	\$ 74,327	\$ --	\$

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Other operating expenses	--	--	--	--	--
	-----	-----	-----	-----	-----
Total expenses	\$ 60,951	\$ 42,212	\$ 74,327	\$ --	\$ --
	=====	=====	=====	=====	=====
Equity in net income (loss) of unconsolidated companies	\$ 1,471	\$ --	\$ 6,179	\$ (417)	\$ --
	=====	=====	=====	=====	=====
Funds from operations	\$ 80,502	\$ 12,637	\$ 12,474	\$ 5,374	\$ --
	=====	=====	=====	=====	=====

SELECTED FINANCIAL INFORMATION:

FOR THE SIX MONTHS ENDED JUNE 30, 2003

(in thousands)	OFFICE SEGMENT	RESORT/HOTEL SEGMENT	RESIDENTIAL DEVELOPMENT SEGMENT	TEMPERATURE-CONTROLLED LOGISTICS SEGMENT	CORPORATE AND OTHER
	-----	-----	-----	-----	-----
Property revenues	\$ 256,068 (1)	\$ 115,353	\$ 89,572	\$ --	\$ --
Other income	--	--	--	--	--
Total revenue	\$ 256,068	\$ 115,353	\$ 89,572	\$ --	\$ --
	=====	=====	=====	=====	=====
Property operating expenses	\$ 123,404	\$ 92,399	\$ 80,760	\$ --	\$ --
Other operating expenses	--	--	--	--	1
Total expenses	\$ 123,404	\$ 92,399	\$ 80,760	\$ --	\$ 1
	=====	=====	=====	=====	=====
Equity in net income (loss) of unconsolidated companies	\$ 3,322	\$ 2,125	\$ 2,510	\$ 1,101	\$ --
	=====	=====	=====	=====	=====
Funds from operations	\$ 142,271	\$ 27,987	\$ 10,993	\$ 12,096	\$ (1)
	=====	=====	=====	=====	=====

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CRESCENT REAL ESTATE EQUITIES COMPANY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SELECTED FINANCIAL INFORMATION:

FOR THE SIX MONTHS ENDED JUNE 30, 2002

(in thousands)	OFFICE SEGMENT	RESORT/HOTEL SEGMENT	RESIDENTIAL DEVELOPMENT SEGMENT	TEMPERATURE-CONTROLLED LOGISTICS SEGMENT	CORPORATE AND OTHER
	-----	-----	-----	-----	-----
Property revenues	\$ 277,967 (1)	\$ 92,047	\$ 126,541	\$ --	\$ --
Other income	--	--	--	--	--
Total revenue	\$ 277,967	\$ 92,047	\$ 126,541	\$ --	\$ --
	=====	=====	=====	=====	=====
Property operating expenses	\$ 124,599	\$ 66,102	\$ 113,678	\$ --	\$ --

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Other operating expenses	--	--	--	--	1
	-----	-----	-----	-----	---
Total expenses	\$ 124,599	\$ 66,102	\$ 113,678	\$ --	\$ 1
	=====	=====	=====	=====	===
Equity in net income (loss) of unconsolidated companies	\$ 2,781	\$ --	\$ 18,662	\$ (727)	\$
	=====	=====	=====	=====	===
Funds from operations	\$ 161,074	\$ 33,547	\$ 28,035	\$10,775	\$ (1
	=====	=====	=====	=====	===

-----  
See footnotes to the following table.

(in millions)	OFFICE SEGMENT	RESORT/HOTEL SEGMENT	RESIDENTIAL DEVELOPMENT SEGMENT	TEMPERATURE- CONTROLLED LOGISTICS SEGMENT
-----	-----	-----	-----	-----
TOTAL ASSETS BY SEGMENT: (3)				
Balance at June 30, 2003	\$ 2,529	\$ 499	\$ 748	\$ 303
Balance at December 31, 2002	2,626	502	723	304
CONSOLIDATED PROPERTY LEVEL FINANCING:				
Balance at June 30, 2003	\$ (1,368)	\$ (133)	\$ (87)	\$ --
Balance at December 31, 2002	(1,371)	(130)	(93)	--
CONSOLIDATED OTHER LIABILITIES:				
Balance at June 30, 2003	\$ (92)	\$ (40)	\$ (136)	\$ --
Balance at December 31, 2002	(135)	(44)	(125)	--
MINORITY INTERESTS:				
Balance at June 30, 2003	\$ (8)	\$ (7)	\$ (24)	\$ --
Balance at December 31, 2002	(11)	(8)	(25)	--

- 
- (1) Includes lease termination fees (net of the write-off of deferred rent receivables) of approximately \$0.9 million and \$0.6 million for the three months ended June 30, 2003 and 2002, respectively and \$2.9 million and \$1.7 million for the six months ended June 30, 2003 and 2002, respectively.
- (2) For purposes of this Note, Corporate and Other include income from investment land sales, net, corporate interest and other income, general and administrative, interest expense, depreciation and amortization, amortization of deferred financing costs, preferred return paid to GMAC Commercial Mortgage Corporation ("GMACCM") for 2002, preferred dividends, other unconsolidated companies, impairment and other charges and other expenses.
- (3) Total assets by segment is inclusive of investments in real estate mortgages and equity of unconsolidated companies, net of unconsolidated debt.
- (4) Inclusive of Corporate bonds and credit facility.
- (5) The following table presents a reconciliation of Consolidated Funds from Operations to Net Income (Loss).

CRESCENT REAL ESTATE EQUITIES COMPANY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

RECONCILIATION OF CONSOLIDATED FUNDS FROM OPERATIONS

(in thousands) -----	FOR THE THREE MONTHS ENDED JUNE 30,		F
	2003	2002	20
Consolidated Funds from Operations	\$ 36,441	\$ 53,205	\$ 7
Adjustments to reconcile Consolidated Funds from Operations to Net Income (Loss):			
Depreciation and amortization of real estate assets	(33,099)	(33,530)	(6
(Loss) gain on property sales, net	(62)	1,420	
Impairment and other adjustments related to real estate assets and assets held for sale	(990)	--	(1
Cumulative effect of a change in accounting principle	--	--	
Adjustment for investments in real estate mortgages and equity of unconsolidated companies:			
Office Properties	(3,013)	(1,889)	(
Resort/Hotel Properties	(355)	--	
Residential Development Properties	512	(2,051)	
Temperature-Controlled Logistics Properties	(5,486)	(5,790)	(1
Other	104	(3,130)	
Unitholder minority interest	(105)	(1,508)	
Series A Preferred share distributions	4,556	4,215	
Series B Preferred share distributions	2,019	1,009	
	-----	-----	-----
Net Income (Loss)	\$ 522	\$ 11,951	\$ (1
	=====	=====	=====

#### 4. DISCONTINUED OPERATIONS

In August 2001, the FASB issued SFAS No. 144, which requires that the results of operations of assets sold or held for sale, and any gains or losses recognized on assets sold and held for sale, be disclosed separately in the Company's Consolidated Statements of Operations. The Company adopted SFAS No. 144 on January 1, 2002. In accordance with SFAS No. 144, the results of operations of the assets sold or held for sale have been presented as "Discontinued operations - income (loss) on assets sold and held for sale," and gain or loss and impairments in the assets sold or held for sale have been presented as "Discontinued operations - (loss) gain on assets sold and held for sale" in the accompanying Consolidated Statements of Operations for the three and six months ended June 30, 2003 and 2002. The impairment charges represent the difference between the carrying value of assets sold or held for sale and the actual or estimated sales price, less costs of sale. The carrying value of the assets held for sale has been reflected as "Properties held for disposition, net" in the accompanying Consolidated Balance Sheets as of June 30, 2003 and December 31, 2002.



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### ASSETS HELD FOR SALE

#### OFFICE SEGMENT

As of June 30, 2003, the 1800 West Loop South Office Property located in the West Loop/Galleria submarket in Houston, Texas was held for sale. During the six months ended June 30, 2003, the Company recognized an approximately \$12.7 million impairment charge, net of minority interests, on the 1800 West Loop South Office Property.

As of June 30, 2003, the Company determined that the North Dallas Athletic Club, a building adjacent to the Stanford Corporate Centre Office Property in the Far North Dallas submarket in Dallas, Texas was no longer held for sale due to the Company's negotiations to contract a new operator. The Property has been reclassified from "Properties held for disposition, net" to "Building and improvements," "Furniture, fixtures and equipment" and "Accumulated depreciation" in the accompanying Consolidated Balance Sheets with a book value of \$0.6 million, net of accumulated depreciation of \$0.8 million. The impairment charge of \$1.0 million, net of minority interest, recorded during the first quarter of 2003, has been reclassified from "Discontinued operations - (loss) gain on assets sold and held for sale" to "Impairment and other charges related to real estate assets" in the accompanying Consolidated Statement of Operations.

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### CRESCENT REAL ESTATE EQUITIES COMPANY NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### BEHAVIORAL HEALTHCARE PROPERTIES

On February 27, 2003, the Company sold a behavioral healthcare property for \$2.0 million, consisting of \$1.3 million in cash and a \$0.7 million note receivable. The Company recognized a loss on the sale of this property of approximately \$0.3 million. A \$2.3 million impairment charge, net of minority interest, had been recognized during 2002 related to this property.

On May 2, 2003, the Company sold one additional behavioral healthcare property for \$2.1 million. The Company recognized a loss on the sale of this property of approximately \$0.1 million. A \$0.7 million impairment charge, net of minority interest, was recognized during the first quarter of 2003 related to this property.

The Company also recognized a \$0.8 million impairment charge, net of minority interest, during the second quarter of 2003 on a behavioral healthcare property held for sale and under contract for sale at June 30, 2003. This property was sold on July 10, 2003.

As of June 30, 2003, the Company owned five behavioral healthcare properties.

#### SUMMARY OF ASSETS HELD FOR SALE

The following table indicates the major classes of assets of the Properties held for sale.

(in thousands)	JUNE 30, 2003(1)	DECEMBER 31, 2002
----------------	------------------	-------------------

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Land	\$ 9,523	\$ 12,802
Buildings and improvements	39,291	56,875
Furniture, fixture and equipment	935	1,665
Accumulated depreciation	(8,847)	(9,873)
	-----	-----
Net investment in real estate	\$ 40,902	\$ 61,469
	=====	=====

-----

(1) Includes the 1800 West Loop South Office Property and five behavioral healthcare properties.

The following table presents rental revenue, operating expenses, depreciation and amortization, net income and impairments for the six months ended June 30, 2003 and 2002 for Properties held for sale as of June 30, 2003.

FOR THE SIX MONTHS ENDED JUNE 30,

	REVENUE (1)	OPERATING EXPENSES (1)	DEPRECIATION AND AMORTIZATION (1)	NET INCOME (1)	IMPAIRMENTS (2)
	-----	-----	-----	-----	-----
(in thousands)					
	-----				
2003	\$2,889	\$1,548	\$303	\$1,038	\$16,818
2002	2,802	1,623	819	360	--

-----

(1) Includes the 1800 West Loop South Office Property.

(2) Includes impairments of 1800 West Loop South and two behavioral healthcare properties, before minority interests of \$2.6 million.

5. OTHER ASSET DISPOSITIONS

INVESTMENT LAND DISPOSITIONS

On April 24, 2003, the Company completed the sale of approximately one-half acre of undeveloped land located in Dallas, Texas. The sale generated net proceeds and a net gain of approximately \$0.3 million. This land was wholly-owned by the Company.

On May 15, 2003, the Company completed the sale of approximately 24.8 acres of undeveloped land located in Coppell, Texas. The sale generated net proceeds of \$3.0 million and a net gain of approximately \$1.1 million. This land was wholly-owned by the Company.

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As of June 30, 2003, the Company sold approximately 3.5 acres of undeveloped land located in Houston, Texas. Subsequent to the end of the second quarter, the sale agreement was modified. Under the terms of the modified sale agreement, the Company generated proceeds of \$2.1 million, net of closing costs, and a note receivable in the amount of \$11.8 million, with annual installments of principal and interest payments beginning June 27, 2004 through maturity on June 27, 2010. The principal payment amounts are calculated based upon a 20-year amortization and the interest rate is 4% for the first two years and thereafter the prime rate, as defined in the note, through maturity. Based on the terms of the modified sale agreement, the Company will fully recognize a net gain of approximately \$8.9 million in the third quarter of 2003. This land was wholly-owned by the Company.

### 6. TEMPERATURE-CONTROLLED LOGISTICS SEGMENT

#### TEMPERATURE-CONTROLLED LOGISTICS PROPERTIES

As of June 30, 2003, the Company held a 40% interest in the Temperature-Controlled Logistics Partnership, which owns the Temperature-Controlled Logistics Corporation, which directly or indirectly owns the 88 Temperature-Controlled Logistics Properties, with an aggregate of approximately 441.5 million cubic feet (17.5 million square feet) of warehouse space.

The Temperature-Controlled Logistics Corporation leases the Temperature-Controlled Logistics Properties to AmeriCold Logistics, a limited liability company owned 60% by Vornado Operating L.P. and 40% by a subsidiary of Crescent Operating, Inc. ("COPI"). The Company has no economic interest in AmeriCold Logistics. See Note 15, "COPI," for information on the proposed acquisition of COPI's 40% interest in AmeriCold Logistics by a new entity to be owned by the Company's shareholders.

AmeriCold Logistics, as sole lessee of the Temperature-Controlled Logistics Properties, leases the Temperature-Controlled Logistics Properties from the Temperature-Controlled Logistics Corporation under three triple-net master leases, as amended. On February 22, 2001, the Temperature-Controlled Logistics Corporation and AmeriCold Logistics agreed to restructure certain financial terms of the leases, including a reduction of the rental obligation for 2001 and 2002, the increase of the Temperature-Controlled Logistics Corporation's share of capital expenditures for the maintenance of the properties (effective January 1, 2000) and the extension of the date on which deferred rent is required to be paid to December 31, 2003. On March 7, 2003, the Temperature-Controlled Logistics Corporation and AmeriCold Logistics amended the leases to further extend the date on which deferred rent is required to be paid to December 31, 2004.

AmeriCold Logistics deferred \$18.5 million of the total \$76.4 million of rent payable for the six months ended June 30, 2003. The Company's share of the deferred rent was \$7.4 million. The Company recognizes rental income from the Temperature-Controlled Logistics Properties when earned and collected and has not recognized the \$7.4 million of deferred rent in equity in net income of the Temperature-Controlled Logistics Properties for the six months ended June 30, 2003. As of June 30, 2003, the Temperature-Controlled Logistics Corporation's deferred rent and valuation allowance from AmeriCold Logistics were \$59.1 million and \$52.8 million, respectively, of which the Company's portions were \$23.6 million and \$21.1 million, respectively.

#### VORNADO CRESCENT CARTHAGE AND KC QUARRY, L.L.C.

As of June 30, 2003, the Company held a 56% interest in Vornado

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Crescent Carthage and KC Quarry, L.L.C. ("VCQ"). The assets of VCQ include two quarries and the related land. The Company accounts for this investment as an unconsolidated equity investment because the Company does not control the joint venture.

On December 31, 2002, VCQ purchased \$5.7 million of trade receivables from AmeriCold Logistics at a 2% discount. The Company contributed approximately \$3.1 million to VCQ for the purchase of the trade receivables. The receivables were collected during the three months ended March 31, 2003.

On March 28, 2003, VCQ purchased \$6.6 million of trade receivables from AmeriCold Logistics at a 2% discount. VCQ used cash from collection of trade receivables previously purchased from AmeriCold Logistics and a \$2.0 million contribution from its owners, of which approximately \$0.8 million represented the Company's contribution, for the purchase of the trade receivables. The receivables were collected during the three months ended June 30, 2003.

On May 22, 2003, VCQ distributed cash of \$3.2 million to the Company.

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### CRESCENT REAL ESTATE EQUITIES COMPANY NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### 7. INVESTMENTS IN REAL ESTATE MORTGAGES AND EQUITY OF UNCONSOLIDATED COMPANIES

The Company has investments of 20% to 50% in seven unconsolidated joint ventures that own seven Office Properties. The Company does not have control of these joint ventures, and therefore, these investments are accounted for using the equity method of accounting.

The Company, through ownership interests of 50% or less, or ownership of non-voting interests only, has other unconsolidated investments which it does not control; these investments are accounted for using the equity method of accounting.

The following is a summary of the Company's ownership in significant unconsolidated joint ventures and equity investments as of June 30, 2003.

ENTITY	CLASSIFICATION
Joint Ventures	
Main Street Partners, L.P.	Office (Bank One Center - Dallas)
Crescent Miami Center, L.L.C.	Office (Miami Center - Miami)
Crescent 5 Houston Center, L.P.	Office (5 Houston Center - Houston)
Austin PT BK One Tower Office Limited Partnership	Office (Bank One Tower - Austin)
Houston PT Four Westlake Park Office Limited Partnership	Office (Four Westlake Park - Houston)
Houston PT Three Westlake Park Office Limited Partnership	Office (Three Westlake Park - Houston)
Crescent Five Post Oak Park L.P.	Office (Five Post Oak - Houston)
Equity Investments	
The Woodlands Land Development Company, L.P.	Residential Development
Blue River Land Company, L.L.C.	Residential Development
Manalapan Hotel Partners, L.L.C.	Resort/Hotel (Ritz Carlton Palm Beach)

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Vornado Crescent Portland Partnership	Temperature-Controlled Logistics
Vornado Crescent Carthage and KC Quarry, L.L.C.	Temperature-Controlled Logistics
The Woodlands Commercial Properties Company, L.P.	Office
CR License, L.L.C.	Other
The Woodlands Operating Company, L.P.	Other
Canyon Ranch Las Vegas, L.L.C.	Other
SunTx Fulcrum Fund, L.P.	Other
G2 Opportunity Fund, L.P.	Other

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- (1) The remaining 50% interest in Main Street Partners, L.P. is owned by Trizec Properties, Inc.
- (2) The remaining 60% interest in Crescent Miami Center, L.L.C. is owned by an affiliate of a fund managed by JP Morgan Fleming Asset Management, Inc.
- (3) The remaining 75% interest in Crescent 5 Houston Center, L.P. is owned by a pension fund advised by JP Morgan Fleming Asset Management, Inc.
- (4) The remaining 80% interest in each of Austin PT BK One Tower Office Limited Partnership, Houston PT Three Westlake Park Office Limited Partnership and Houston PT Four Westlake Park Office Limited Partnership is owned by an affiliate of General Electric Pension Trust.
- (5) The remaining 70% interest in Crescent Five Post Oak Park L.P. is owned by an affiliate of General Electric Pension Trust.
- (6) The remaining 57.5% interest in each of the Woodlands Land Development Company, L.P. ("WLDC"), The Woodlands Commercial Properties Company, L.P. ("Woodlands CPC") and The Woodlands Operating Company, L.P. is owned by an affiliate of Morgan Stanley.
- (7) Distributions are made to partners based on specified payout percentages. During the six months ended June 30, 2003, the payout percentage to the Company was 52.5%.
- (8) The remaining 50% interest in Blue River Land Company, L.L.C. is owned by parties unrelated to the Company.
- (9) The remaining 50% interest in Manalapan Hotel Partners, L.L.C. ("Manalapan") is owned by WB Palm Beach Investors, L.L.C.
- (10) The remaining 60% interest in Vornado Crescent Portland Partnership is owned by Vornado Realty Trust, L.P.
- (11) The remaining 44% in Vornado Crescent Carthage and KC Quarry, L.L.C. is owned by Vornado Realty Trust, L.P.
- (12) The remaining 70% interest in CR License, L.L.C. is owned by an affiliate of the management company of two of the Company's Resort/Hotel Properties.
- (13) The remaining 35% interest in Canyon Ranch Las Vegas, L.L.C. is owned by an affiliate of the management company of two of the Company's Resort/Hotel Properties.

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### CRESCENT REAL ESTATE EQUITIES COMPANY NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

- (14) The SunTx Fulcrum Fund, L.P.'s ("SunTx") objective is to invest in a portfolio of acquisitions that offer the potential for substantial capital appreciation. The remaining 71.9% of SunTx is owned by a group of individuals unrelated to the Company. The Company's ownership percentage will decline by the closing date of SunTx as capital commitments from third parties are secured. The Company's projected ownership interest at the closing of SunTx is approximately 7.5% based on SunTx manager's expectations for the final SunTx capitalization. The Company accounts for its investment in SunTx under the cost method. The Company's investment at June 30, 2003 was \$6.3 million.
- (15) G2 Opportunity Fund, L.P. ("G2") was formed for the purpose of investing in commercial mortgage backed securities and other commercial real estate investments. Goff-Moore Strategic Partners, L.P. ("GMSP") and GMACCM each own 21.875% of G2, with the remaining 43.75% owned by parties unrelated to the Company. See Note 14, "Related Party Transactions," for information regarding the ownership interests of trust managers and officers of the Company in GMSP.

#### SUMMARY FINANCIAL INFORMATION

The Company reports its share of income and losses based on its ownership interest in its respective equity investments, adjusted for any preference payments. As a result of the Company's transaction with COPI on February 14, 2002, certain entities that were reported as unconsolidated entities in 2002 prior to February 14, 2002 are consolidated in the June 30, 2003 financial statements. Additionally, certain unconsolidated subsidiaries of the newly consolidated entities are now shown separately as unconsolidated entities of the Company. As a result of the Company's January 2, 2003 purchase of the remaining 2.56% economic interest, representing 100% of the voting stock, in DBL Holdings, Inc. ("DBL"), DBL is consolidated in the June 30, 2003 financial statements. Because DBL owns a majority of the voting stock of MVDC and HADC, these two Residential Development Corporations are consolidated in the June 30, 2003 financial statements.

The unconsolidated entities that are included under the headings on the following tables are summarized below.

Balance Sheets as of June 30, 2003:

- o WLDC;
- o Other Residential Development - This includes the Blue River Land Company, L.L.C.;
- o Resort/Hotel - This includes Manalapan;
- o Temperature-Controlled Logistics - This includes the Temperature-Controlled Logistics Partnership and VCQ;
- o Office - This includes Main Street Partners, L.P., Houston PT Three Westlake Park Office Limited Partnership, Houston PT Four Westlake Park Office Limited Partnership, Austin PT BK One Tower Office Limited Partnership, Crescent 5 Houston Center, L.P., Crescent Miami Center, L.L.C., Crescent Five Post Oak Park L.P. and Woodlands CPC; and

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- o Other - This includes CR License, L.L.C., The Woodlands Operating Company, L.P., Canyon Ranch Las Vegas, L.L.C., SunTx and G2.

Balance Sheets as of December 31, 2002:

- o WLDC;
- o Other Residential Development - This includes the Blue River Land Company, L.L.C., MVDC and HADC;
- o Resort/Hotel - This includes Manalapan;
- o Temperature-Controlled Logistics - This includes the Temperature-Controlled Logistics Partnership and VCQ;
- o Office - This includes Main Street Partners, L.P., Houston PT Three Westlake Park Office Limited Partnership, Houston PT Four Westlake Park Office Limited Partnership, Austin PT BK One Tower Office Limited Partnership, Crescent 5 Houston Center, L.P., Crescent Miami Center, L.L.C., Crescent Five Post Oak Park L.P. and Woodlands CPC; and
- o Other - This includes DBL, CR License, L.L.C., The Woodlands Operating Company, L.P., Canyon Ranch Las Vegas, L.L.C. and SunTx.

Summary Statements of Operations for the six months ended June 30, 2003:

- o WLDC;
- o Other Residential Development - This includes the operating results for Blue River Land Company, L.L.C.;
- o Resort/Hotel - This includes the operating results for Manalapan;
- o Temperature-Controlled Logistics - This includes the operating results for the Temperature-Controlled Logistics Partnership and VCQ;

### CRESCENT REAL ESTATE EQUITIES COMPANY NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

- o Office - This includes the operating results for Main Street Partners, L.P., Houston PT Three Westlake Park Office Limited Partnership, Houston PT Four Westlake Park Office Limited Partnership, Austin PT BK One Tower Office Limited Partnership, Crescent 5 Houston Center, L.P., Crescent Miami Center L.L.C., Crescent Five Post Oak Park L.P. and Woodlands CPC; and
- o Other - This includes the operating results for CR License, L.L.C., The Woodlands Operating Company,

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L.P., Canyon Ranch Las Vegas, L.L.C., SunTx and G2.

Summary Statements of Operations for the six months ended June 30, 2002:

- o WLDC - This includes WLDC's operating results for the period February 15 through June 30, 2002 and TWLC's operating results for the period January 1 through February 14, 2002;
- o Other Residential Development - This includes the operating results for DMDC and CRDI for the period January 1 through February 14, 2002, the operating results of Blue River Land Company, L.L.C. and Manalapan for the period February 15 through June 30, 2002, and the operating results of MVDC and HADC;
- o Temperature-Controlled Logistics - This includes the operating results for the Temperature-Controlled Logistics Partnership;
- o Office - This includes the operating results for Main Street Partners, L.P., Houston PT Four Westlake Park Office Limited Partnership, Austin PT BK One Tower Office Limited Partnership, Crescent 5 Houston Center, L.P. and Woodlands CPC; and
- o Other - This includes the operating results for DBL, CR License, L.L.C., The Woodlands Operating Company, Canyon Ranch Las Vegas, L.L.C. and SunTx.

BALANCE SHEETS:

AS OF JUNE 30, 2003

(in thousands)	THE WOODLANDS LAND DEVELOPMENT COMPANY, L.P.	OTHER RESIDENTIAL DEVELOPMENT CORPORATIONS	RESORT/ HOTEL	TEMPERATURE- CONTROLLED LOGISTICS
Real estate, net	\$390,043	\$ 54,584	\$ 80,732	\$1,210,630
Cash	6,627	1,233	8,436	35,514
Other assets	47,340	781	5,243	90,713
Total assets	\$444,010 =====	\$ 56,598 =====	\$ 94,411 =====	\$1,336,857 =====
Notes Payable	\$288,230	\$ 7,650	\$ 56,000	\$ 567,349
Notes Payable to the Company	11,122	--	--	--
Other liabilities	53,987	4,400	7,215	8,433
Equity	90,671	44,548	31,196	761,075
Total liabilities and equity	\$444,010 =====	\$ 56,598 =====	\$ 94,411 =====	\$1,336,857 =====
Company's share of unconsolidated debt	\$122,500 =====	\$ 3,825 =====	\$ 28,000 =====	\$ 226,940 =====
Company's investments in real estate mortgages and equity of				



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unconsolidated companies	\$ 36,630 =====	\$ 27,741 =====	\$ 15,598 =====	\$ 303,279 =====
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BALANCE SHEETS:

AS OF DECEMBER 31, 2002

(in thousands)	THE WOODLANDS LAND DEVELOPMENT COMPANY, L.P.	OTHER RESIDENTIAL DEVELOPMENT CORPORATIONS	RESORT/ HOTEL	TEMPERATURE- CONTROLLED LOGISTICS
Real estate, net	\$388,587	\$ 68,235	\$ 81,510	\$1,238,810
Cash	15,289	7,112	3,022	13,213
Other assets	46,934	3,303	4,415	88,327
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