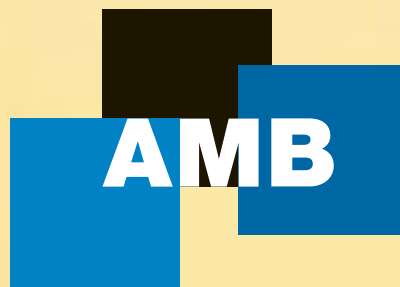


Three wooden blocks are stacked vertically. The top block has the letter 'A' on its front face, the middle block has 'M', and the bottom block has 'B'. The blocks are slightly offset to the left, creating a sense of depth. The lighting is soft, casting a gentle shadow to the right and slightly forward.

**AMB Property Corporation**

**1998**  
**annual report**



# ***building alliances*** ***building value***

**AMB Property Corporation** is one of the largest Real Estate Investment Trusts in the United States. The Company is active in markets across the country and focuses primarily on industrial properties located in major distribution markets. Through its Strategic Alliance Programs, AMB is creating innovative, mutually beneficial alliances with other real estate professionals that are expanding and enhancing the value of its property portfolio. The Company owns and operates 620 buildings and centers totaling 63.6 million square feet.

AMB common stock trades on the New York Stock Exchange under the symbol AMB.

# Financial Highlights

AMB PROPERTY CORPORATION

For the Years Ended December 31,

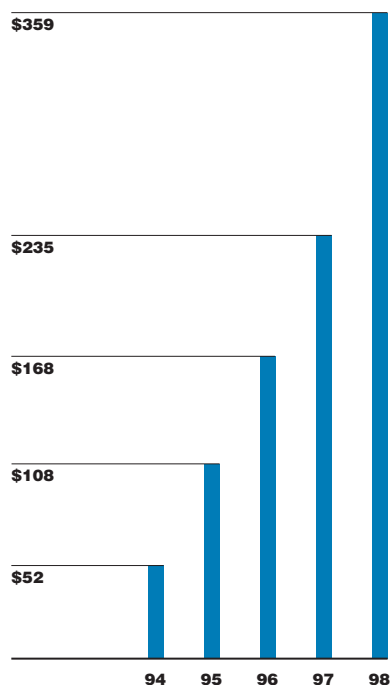
(In thousands, except per share data)	Historical Properties <sup>(1)</sup>					Company	
				Pro Forma <sup>(2)</sup>			
	1994	1995	1996	1997	1997	1998	
Revenues	\$ 51,682	\$ 108,249	\$ 167,953	\$ 235,225	\$ 284,674	\$ 358,887	
Net operating income	34,938	71,358	112,632	154,367	203,196	262,813	
EBITDA					195,218	252,353	
FFO					147,409	170,407	
FFO per share (diluted)					1.66	1.90	

As of December 31,

(In thousands)	Historical Properties			Company	
	1994	1995	1996	1997	1998
Total assets	\$ 721,131	\$ 1,117,181	\$ 1,622,559	\$ 2,506,255	\$ 3,562,885
Debt	201,959	254,067	548,134	685,652	1,368,196
Market equity				2,221,469	1,988,038
Shares and units outstanding				88,417	90,365
Square feet	15,786	24,897	34,891	43,545	63,596
Occupancy	96.4%	96.7%	96.5%	95.8%	95.8%

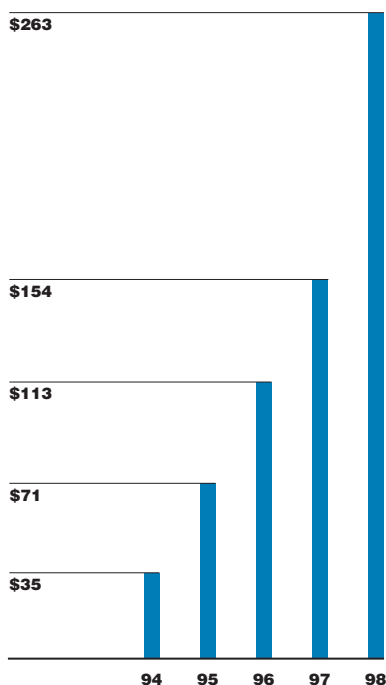
## Revenues

(dollars in millions)



## Net Operating Income

(dollars in millions)



## FFO Per Share (diluted)

(dollars per share)



<sup>(1)</sup>The historical results for 1997 include the results of the Company for the period from November 26, 1997, the commencement of operations as a fully integrated REIT, to December 31, 1997 and the results achieved by the prior owners of the Properties for the period from January 1, 1997 to November 25, 1997, and the years ended December 31, 1994, 1995 and 1996.

<sup>(2)</sup>The pro forma financial information has been prepared as if the formation transactions, initial public offering, property acquisitions and dispositions during 1997 and certain other transactions had occurred on January 1, 1997.



## ***to our shareholders***

No one has ever accused AMB of being a typical company. Over the past 15 years, we have made a point of differentiating ourselves. Our initial public offering in November 1997 is a case in point. Conventional wisdom said there was no compelling reason for us to go public. We were a successful investment manager, but we believed public ownership would maximize returns for our investors, improve our operating efficiency, and give us a valuable new form of currency to fuel our growth. In other words, we saw tremendous opportunity in public ownership, and now following our first full year as a public company, we can measure the financial and strategic impact of our decision.

For the year, funds from operations per share grew 14.5% while same store net operating income grew 7.1%. We significantly strengthened our financial flexibility, raising \$675 million in new capital in part by executing a large-scale unsecured debt financing. We acquired properties totaling \$838 million, added 19.1 million square feet to our portfolio, and initiated \$262 million in development projects. We ended the year with 620 industrial buildings and retail centers, totaling 63.6 million square feet, and a capitalization exceeding \$3.7 billion, making us one of the nation's leading public REITs.

AMB also took a key strategic step early in 1999 when we signed agreements to sell most of our retail properties for \$663 million. This move underscores our belief that the growth of third party logistics, airfreight and e-commerce are driving a fundamental, long-term change in how goods are distributed. For industrial property leaders such as AMB, these trends will be highly favorable. Going forward, our portfolio will emphasize properties that are critical links in the supply chain, especially high-turnover warehouse/distribution facilities near major air cargo hubs and convenient to major freeways or ports. This market sector has been a growing area of focus and strength for AMB, and we intend to extend our leadership position in this area.

AMB has made important progress in other areas of our business, as well. For example, we are steadily expanding the AMB brand in our target markets. Through our unique outsourcing model, we have continued to build strong ties with leading real estate organizations. Our national network of strategic alliances is a valuable competitive advantage for AMB that positions us as a partner, rather than a competitor of local real estate entrepreneurs. Our alliances give us access to properties not readily available to traditional REITs, and make us an efficient and flexible operator.

For these and many other reasons we feel the future is very bright at AMB. We have a proven ability to create value and, looking to 1999 and beyond, we believe we can extend our solid track record and maximize the significant opportunities we see ahead. Our optimism is based not only on market trends, but also on two particular strengths at AMB: our ability to generate growth internally and the valuable alliances we have forged with top real estate entrepreneurs throughout the country.

**GENERATING GROWTH INTERNALLY** The importance of generating internal growth is underscored by the changing financial dynamics of the public real estate market, especially the increasing cost of equity capital. In the past, most REITs fueled earnings growth through the spread between the cost of capital and the returns generated through acquisitions. At AMB we have not depended on that model. We have been highly selective in how we deploy capital, building a portfolio of quality properties that generate strong, steady and growing cash flow in both good and bad market cycles. In other words, we do not need to rely primarily on acquisitions to drive our profit growth.

This strategy reflects several factors that are rapidly becoming AMB hallmarks. First, we have deployed capital carefully over the years in high quality properties in supply-constrained markets. Second, we have made – and continue

to make – the necessary investments in those properties to ensure that our tenants are satisfied. And third, we outsource on-site activities to top property management and brokerage firms that maximize each property’s operating efficiency and tenant satisfaction. The success of this strategy speaks for itself. Our 7.1% same store NOI growth in 1998 – among the highest in our industry – was largely fueled by a 14.3% increase in base rents.

Another unique attribute of AMB that reduces our exposure to changing capital markets is our ability to access private funding. AMB was founded as an investment manager for private institutional investors and – unlike most other REITs – private capital continues to be a thriving part of our business under our Institutional Alliance Program.

Private capital increases AMB’s return on investment, and provides access to alternative capital sources. This “stretches” our internally generated capital and allows AMB to participate in a wide array of high quality acquisitions without diluting our current shareholders.

#### **STRONG ALLIANCES/NEW GROWTH OPPORTUNITIES**

The success of our Institutional Alliance Program is mirrored in AMB’s other Strategic Alliance Programs. The objective of our alliances is to strengthen the ties between AMB and other real estate professionals to create mutually beneficial relationships. In an industry of increasing specialization we believe that we can most effectively build shareholder value by focusing on our core strengths, investing and setting long-term strategy, while outsourcing and collaborating with firms that have complementary strengths in day-to-day leasing, management, and development. I encourage you to read the pages that follow for a more detailed look at our Strategic Alliance Programs and how they contribute to AMB’s success.

These professional collaborations have proven very productive. In fact, 72% of AMB’s acquisition volume in 1998 was sourced through these programs, including \$138 million through our Management Alliance Program and \$216 million generated by our UPREIT Alliance Program. In addition, substantially all of our \$262 million in development starts during 1998 were initiated through the Development Alliance Programs.



*Hamid R. Moghadam  
President and  
Chief Executive Officer*

We are devoting a majority of our development efforts to industrial properties that serve the distribution and logistics markets. Airfreight distribution, in particular, is an especially fast growing sector – expanding at two-and-a half times the rate of GDP growth – and one of the drivers of its continued growth will be e-commerce. Web retailers depend on fast delivery to differentiate themselves from traditional and mail-order retailers and to build customer loyalty. Beyond the airfreight companies themselves, the key provider in the modern high-speed fulfillment chain will be the physical warehouses on or near the runways of major air cargo facilities. With 15 years of experience serving the warehousing/transportation market, we have an excellent head start in this arena. We have already completed our first on-tarmac development, at the Dallas-Ft. Worth Airport, and we are actively seeking other key opportunities.

In closing, I want to thank two AMB veterans who retired this past year: Dave Carniglia, our Chief Financial Officer, and Jean Hurley, who directed our corporate communications and investor relations efforts. Both played very important roles in the Company's growth over the years, and we thank them for their contributions to AMB's growth and success.

I also want to welcome two new members of our senior management team: David Fries, our new Chief Administrative Officer and General Counsel, and Blake Baird who joined us recently from his position as a Managing Director at Morgan Stanley to become AMB's Chief Investment Officer. David and Blake are the latest additions to what I firmly believe is the strongest group of professionals in the real estate industry. Indeed, for all of AMB's innovative strategic thinking and strong industry alliances, our most important competitive advantage has always been and will continue to be our people. I want to express my pride and appreciation for the excellent job they have done embracing and managing change over the past year.



Hamid R. Moghadam  
President and Chief Executive Officer

March 31, 1999

# ***strategic alliance***

## *programs*

AMB's Strategic Alliance Programs are designed to build value by creating mutually beneficial relationships. Real estate is fundamentally a local business, and we believe the most effective way for a national company to operate is by forging alliances with the best available service providers in every market. Such collaborations enable AMB to leverage the expertise and resources of local developers, brokers, property managers, and other owners of real estate without incurring the risk and expense of doing everything ourselves. This attitude is counter to the conventional wisdom in our industry of integrating vertically; but, based on our successful history, outsourcing and alliance building is a winning 21st century business model for AMB. It has improved our operating efficiency and flexibility, strengthened our customer satisfaction and retention, and perhaps most important, provided a continuous pipeline of opportunities for growth in the years ahead.





**AMB's six Strategic Alliance Programs are grouped in two categories. Investment Alliance Programs establish relationships with a variety of capital sources, enhancing our ability to source and finance attractive acquisitions. Operating Alliance Programs position AMB as an ally of rather than a competitor with service providers in our industry, giving us access to local market insights, trends and investment opportunities.**



# ***development***

## ***alliance program***

Developing properties requires a special skill that is almost as much of an art as a science. At AMB we seek to work with those developers who have proven they have both the insight to recognize potential in an undervalued asset *and* the skill to realize that potential. The partners in our Development Alliance Program are typically successful entrepreneurs with the ability to execute a renovation or building project quickly and efficiently. Development collaboration allows AMB to expand its revenue potential without incurring undue risk, and it provides an avenue for sharing in high-value opportunities during strong market cycles without carrying the costly overhead that can quickly destroy margins and profitability.



## ***u p r e i t***

### ***a l l i a n c e   p r o g r a m***

For certain property owners seeking ultimate liquidity and a strong alternative investment with tax advantages, we offer our UPREIT Alliance Program. Property owners contribute their assets to AMB and in return receive equity in the form of operating partnership units. Because the transaction provides a useful tax planning structure, the property owners gain valuable flexibility in liquidating their assets. Unique to AMB, owners may also continue to manage the properties they contribute. It's another example of how we adopt flexible approaches to attract high quality assets to the AMB portfolio.



## ***institutional*** *alliance program*

Given AMB's origins as a manager of private real estate funds, it should be no surprise that we recognize the value of providing a private investment vehicle for many of our clients. These discrete relationships with institutional investors preclude the need for us to rely solely on the public markets for equity and debt capital, and they offer a valuable source of incremental fee income and investment returns for AMB. Our institutional partners gain significant benefits as well. The private co-investment format lets institutions unambiguously align their investment goals with those of their asset manager. Perhaps most importantly, the Institutional Alliance Program provides access to AMB's proven expertise in acquiring and managing real estate portfolios for institutional investors of all sizes, types and investment perspectives.



## ***management***

### *alliance program*

The final determinant of each tenant's satisfaction is how well a building is maintained and how quickly any needs are addressed. Most REITs and property owners handle this key function in-house. AMB has chosen to follow a different strategy. We believe real estate management requires a specialized skill set, so we outsource management of our properties to leading local firms, working closely with each to ensure optimum efficiency, quality control, and tenant satisfaction. Not only does this increase our flexibility, reduce our overhead, and improve customer service – a result borne out by our strong operating margins and high level of customer satisfaction – it also gives AMB highly influential allies at the grassroots level who can help us retain our existing tenants and develop new customer relationships.



## ***customer***

### ***alliance program***

As a national property owner with a sharp focus on high-volume warehouse/distribution properties, AMB has built strong relationships over the past two decades with many of its larger, longer-term tenants. Our goal in the Customer Alliance Program is to build on the trust that we have established and deepen those relationships. After all, larger tenants generally have real estate needs throughout the country, not just in individual markets, and we are committed to making their property search/renovation/build-out in new markets as efficient and user-friendly as possible. This isn't just a good customer relations tactic, it's a key component of our strategy for financial growth. By working closely with our existing customers, we can generate a steadily growing stream of incremental revenue from internal sources.



## ***broker***

### *alliance program*

AMB works closely with the top local leasing companies in each of our markets. We understand that there is no better conduit to attracting the fast-growing small- and mid-sized firms in each region. In essence, through the Broker Alliance Program, top brokers become our local sales force and information source, and we give them every incentive – competitive commissions, rapid payment, and of course, excellent real estate – to direct high quality tenants to our properties. The result: AMB has a strong, responsive, productive, and cost-effective sales presence in each of its markets.

***financial review >***



# Selected Company and Predecessor Financial and Other Data

AMB PROPERTY CORPORATION

The following table sets forth selected consolidated historical financial and other data for the Company and its Predecessor on an historical basis for the years ended December 31, 1994, 1995, 1996, 1997 and 1998. Prior to November 26, 1997 (the IPO date), the Company's Predecessor provided real estate investment management services to institutional investors.

(In thousands, except share data, percentages and number of Properties)	As of and for the Years Ended December 31,					
	Predecessor <sup>(1)</sup>			Company		
	1994	1995	1996	Historical <sup>(2)</sup> 1997	Pro Forma <sup>(3)</sup> 1997	1998
<b>OPERATING DATA</b>						
Total revenues	\$ 12,865	\$ 16,865	\$ 23,991	\$ 56,062	\$ 284,674	\$ 358,887
Income from operations						
before minority interests	2,925	3,296	7,140	18,885	103,903	123,750
Net income available to						
common stockholders	2,925	3,262	7,003	18,228	99,508	108,954
Net income per common share:						
Basic <sup>(4)</sup>	0.59	0.64	1.38	1.39	1.16	1.27
Diluted <sup>(4)</sup>	0.59	0.64	1.38	1.38	1.15	1.26
Dividends per common share					1.37	1.37
Dividends per preferred share <sup>(5)</sup>					-	0.99
<b>OTHER DATA</b>						
EBITDA <sup>(6)</sup>					\$ 195,218	\$ 252,353
Funds from operations <sup>(7)</sup>					147,409	170,407
Cash flows provided by (used in):						
Operating activities					131,621	177,180
Investing activities					(607,768)	(796,213)
Financing activities					553,199	604,202
<b>BALANCE SHEET DATA</b>						
Investments in real						
estate at cost	\$ -	\$ -	\$ -	\$ 2,442,999		\$ 3,369,060
Total assets	4,092	4,948	7,085	2,506,255		3,562,885
Total consolidated debt <sup>(8)</sup>	-	-	-	685,652		1,368,196
Stockholders' equity	3,848	4,241	6,300	1,668,030		1,765,360

<sup>(1)</sup> Represents the Predecessor's historical financial and other data for the years ended December 31, 1994, 1995 and 1996. The Predecessor operated as an investment manager prior to November 26, 1997.

<sup>(2)</sup> The historical 1997 results represent the Predecessor's historical financial and other data for the period January 1, 1997 through November 25, 1997. The financial and other data of the Company, and the Properties acquired in the Formation Transactions, have been included subsequent to November 26, 1997 to December 31, 1997.

<sup>(3)</sup> Pro forma 1997 financial and other data has been prepared as if the Formation Transactions, the IPO (as described in "Note 1 of Notes to Consolidated Financial Statements") and certain property acquisitions and divestitures in 1997 had occurred on January 1, 1997.

<sup>(4)</sup> Basic and diluted net income per share equals the pro forma net income divided by 85,874,513 and 86,156,556 shares, respectively, for 1997, and net income available to common stockholders divided by 85,876,383 and 86,235,176 shares, respectively, for 1998.

<sup>(5)</sup> Dividends for the period commencing on July 27, 1998, the date of Series A Preferred Stock issuance.

<sup>(6)</sup> EBITDA is computed as income from operations before divestiture of Properties and minority interests plus interest expense, income taxes, depreciation and amortization. We believe that in addition to cash flows and net income, EBITDA is a useful financial performance measure for assessing the operating performance of an equity REIT because, together with net income and cash flows, EBITDA provides investors with an additional basis to evaluate the ability of a REIT to incur and service debt and to fund acquisitions and other capital expenditures. Includes an adjustment to reflect the Company's pro rata share of EBITDA in an unconsolidated joint venture. EBITDA is not a measurement of operating performance calculated in accordance with U.S. generally accepted accounting principles and should not be considered as a substitute for operating income, net income, cash flows from operations or other statement of operations or cash flow data prepared in accordance with U.S. generally accepted accounting principles. EBITDA may not be indicative of our historical operating results, nor be predictive of potential future results. While EBITDA is frequently used as a measure of operations and the ability to meet debt service requirements, it is not necessarily comparable to other similarly titled captions of other REITs.

<sup>(7)</sup> Funds from Operations ("FFO") is defined as income from operations before minority interest, gains or losses from sale of real estate and extraordinary losses plus real estate depreciation and adjustment to derive the Company's pro rata share of the FFO of unconsolidated joint ventures, less minority interests' pro rata share of the FFO of consolidated joint ventures and perpetual preferred stock dividends. In accordance with the National Association of Real Estate Investment Trust ("NAREIT") White Paper on FFO, the Company includes the effects of straight-line rents in FFO. We believe that FFO is an appropriate measure of performance for an equity REIT. While FFO is a relevant and widely used measure of operating performance of REITs, it does not represent cash flow from operations or net income as defined by U.S. generally accepted accounting principles, and it should not be considered as an alternative to those indicators in evaluating liquidity or operating performance. Further, FFO as disclosed by other REITs may not be comparable.

<sup>(8)</sup> Secured debt includes unamortized debt premiums of approximately \$18,286, and \$15,217 as of December 31, 1997 and 1998, respectively. See "Notes 2 and 5 of Notes to Consolidated Financial Statements."

# Selected Property Financial and Other Data

AMB PROPERTY CORPORATION

For comparative purposes, the table that follows provides selected historical financial and other data of the Properties. The historical results of the Properties for 1997 include the results achieved by the Company for the period from November 26, 1997 to December 31, 1997 and the results achieved by the prior owners of the Properties for the period from January 1, 1997 to November 25, 1997. The historical results of operations of the Properties for periods prior to November 26, 1997 include Properties that were managed by the Predecessor and exclude the results of four Properties that were contributed to the Company in the Formation Transactions that were not previously managed by the Predecessor. In addition, the historical results of operations include the results of Properties acquired after November 26, 1997, from the date of acquisition of such Properties to December 31, 1997.

(In thousands, except share data, percentages and number of Properties)	As of and for the Years Ended December 31,					
	Properties Combined <sup>(1)</sup>			Company		
	1994	1995	1996	Historical <sup>(2)</sup> 1997	Pro Forma <sup>(3)</sup> 1997	1998
<b>OPERATING DATA</b>						
Rental revenues	\$ 50,893	\$ 106,180	\$ 166,415	\$ 233,856	\$ 282,665	\$ 354,658
<b>BALANCE SHEET DATA</b>						
Investment in real estate at cost	\$ 666,672	\$1,018,681	\$1,616,091	\$ 2,442,999		\$3,369,060
Secured debt <sup>(4)</sup>	201,959	254,067	522,634	535,652		734,196
<b>PROPERTY DATA</b>						
<b>INDUSTRIAL PROPERTIES</b>						
Property net operating income <sup>(5)</sup>					137,955	181,832
Total rentable square footage at end of period	13,364	21,598	29,609	37,329		56,611
Occupancy rate at end of period	96.9%	97.3%	97.2%	95.7%		96.0%
<b>RETAIL PROPERTIES</b>						
Property net operating income <sup>(5)</sup>					64,716	76,752
Total rentable square footage at end of period	2,422	3,299	5,282	6,216		6,985
Occupancy rate at end of period	93.7%	92.4%	92.4%	96.1%		94.6%

<sup>(1)</sup> Represents the Properties' combined historical financial and other data for the years ended December 31, 1994, 1995 and 1996. The historical results of operations of the Properties for periods prior to November 26, 1997 include Properties that were managed by the Predecessor and exclude the results of four properties that were contributed to the Company in the Formation Transactions that were not previously managed by the Predecessor.

<sup>(2)</sup> The historical results of the Properties for 1997 include the results of the Company for the period from November 26, 1997 (acquisition date) to December 31, 1997 and the results achieved by the prior owners of the Properties for the period from January 1, 1997 to November 25, 1997.

<sup>(3)</sup> The pro forma financial and other data has been prepared as if the Formation Transactions, the IPO (see "Note 1 of Notes to Consolidated Financial Statements"), and certain 1997 property acquisitions and divestitures had occurred on January 1, 1997.

<sup>(4)</sup> Secured debt as of December 31, 1997 and 1998 includes unamortized debt premiums of approximately \$18,286 and \$15,217, respectively. See "Notes 2 and 5 of Notes to Consolidated Financial Statements."

<sup>(5)</sup> Property net operating income (NOI) is defined as rental revenue, including reimbursements and straight-line rents, less property level operating expenses. See "Note 13 of Notes to Consolidated Financial Statements."

# Management's Discussion and Analysis of Financial Condition and Results of Operations

AMB PROPERTY CORPORATION

You should read the following discussion and analysis of the consolidated financial condition and results of operations in conjunction with the Notes to Consolidated Financial Statements. Statements contained in this discussion which are not historical facts may be forward looking statements. You can identify forward-looking statements by the use of forward-looking terminology such as "believes," "expects," "may," "will," "should," "seeks," "approximately," "intends," "plans," "pro forma," "estimates" or "anticipates" or the negative of these words and phrases or similar words or phrases. You can also identify forward-looking statements by discussions of strategy, plans or intentions. Forward-looking statements involve numerous risks and uncertainties and you should not rely upon them as predictions of future events. There is no assurance that the events or circumstances reflected in forward-looking statements will be achieved or occur. Forward-looking statements are necessarily dependent on assumptions, data or methods that may be incorrect or imprecise and we may not be able to realize them. The following factors, among others, could cause actual results and future events to differ materially from those set forth or contemplated in the forward-looking statements: defaults or non-renewal of leases by tenants, increased interest rates and operating costs, our failure to obtain necessary outside financing, difficulties in identifying properties to acquire and in effecting acquisitions, our failure to successfully integrate acquired properties and operations, risks and uncertainties affecting property development and construction (including construction delays, cost overruns, our inability to obtain necessary permits and public opposition to these activities), our failure to qualify and maintain our status as a real estate investment trust under the Internal Revenue Code of 1986, as amended, environmental uncertainties, risks related to natural disasters, financial market fluctuations, changes in real estate and zoning laws and increases in real property tax rates. Our success also depends upon economic trends generally, including interest rates, income tax laws, governmental regulation, legislation, population changes and certain other risk factors discussed in the section entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations – Business Risks" in our Annual Report on Form 10-K for the fiscal year ended December 31, 1998. We caution you not to place undue reliance on forward-looking statements, which reflect our analysis only and speak only as of the date of this Annual Report or the dates indicated in the statements.

## General

Because of the significant impact of the Formation Transactions and our initial public offering (the "IPO") on our results of operations, the discussion below is presented as follows:

- results of the Company and its Predecessor for the years ended December 31, 1998, 1997 and 1996; and
- results of the Properties for the years ended December 31, 1998, 1997 and 1996.

See Note 1 of Notes to Consolidated Financial Statements for a discussion of the Formation Transactions.

## Company and Predecessor Results of Operations

The year ended December 31, 1998 was the Company's first full year operating as a real estate operating company. The historical results of the Company for 1997 include its results, including property operations, for the period from November 26, 1997 (the commencement of operations as a fully integrated real estate company) to December 31, 1997 and the results of the Company's Predecessor, an investment manager, for the period from January 1, 1997 to November 25, 1997, and

the years ended December 31, 1997 and 1996. As an investment manager, the Predecessor's revenues consisted primarily of fees earned in connection with real estate management services. Management's discussion and analysis of the Company and Predecessor for the years ended December 31, 1997 and 1996 is limited to investment management and other income and general and administrative expenses, and excludes a discussion of rental revenues, operating expenses, interest expense and depreciation and amortization because such analysis is not comparable or meaningful given the differences in lines of business between the Company and the Predecessor.

### COMPANY AND PREDECESSOR – YEARS ENDED DECEMBER 31, 1998 AND 1997

*Total revenues.* Total revenues, including straight-line rents, tenant reimbursements and other income, totaled \$358.9 million for the year ended December 31, 1998. The Predecessor's revenues consisted primarily of fees earned in connection with real estate management services. As such, no such rental revenues existed for the Predecessor for the years ended December 31, 1997.

# ***Management's Discussion and Analysis of Financial Condition and Results of Operations***

AMB PROPERTY CORPORATION

*Property operating expenses and real estate taxes.* Property operating expenses, including asset management costs and real estate taxes, totaled \$96.1 million for the year ended December 31, 1998. The Predecessor's expenses consisted primarily of salaries and other general and administrative costs. As such, no such property operating expenses existed for the year ended December 31, 1997.

*General and administrative expenses.* Our general and administrative expenses were \$11.9 million for the year ended December 31, 1998, as compared to the Predecessor's investment management expenses of \$19.4 million for the period from January 1, 1997 to November 25, 1997. Investment management expenses of the Predecessor consisted primarily of salaries and other general and administrative expenses. The 46.1% decrease on an annualized basis in general and administrative expenses is attributable to the change in our operations from an investment manager to a fully integrated real estate company, and the formation of AMB Investment Management. In connection with the Formation Transactions, AMB Investment Management assumed employment and other related costs of certain employees who transferred from the Predecessor to AMB Investment Management for the purpose of carrying on the investment management business.

## **COMPANY AND PREDECESSOR – YEARS ENDED DECEMBER 31, 1997 AND 1996**

*Investment management and other income.* Investment management and other income for the period from January 1, 1997 to November 25, 1997 was \$29.0 million, which on an annualized basis represents a 34.1% increase over the year ended December 31, 1996. The increase reflects the growth in the portfolio under management. Investment management and other income for the period from November 26, 1997 to December 31, 1997 was \$0.6 million.

*General and administrative expenses.* General and administrative expenses for the period from January 1, 1997 to November 25, 1997 were \$19.4 million, which represents a 27.7% increase on an annualized basis over the year ended December 31, 1996. The increase was attributable to an increase in staffing that resulted from the growth in the portfolio under management.

## ***Properties Results of Operations***

The historical results of operations of the Properties for periods prior to November 26, 1997 include Properties that were managed by the Predecessor and exclude the results of four properties that were contributed to the Company in the Formation Transactions that the Predecessor did not previously manage. The discussion below for the years ended December 31, 1997 and 1996 is limited to a discussion of rental revenues, property operating expense and real estate taxes and excludes an analysis of other income, interest expense and depreciation and amortization because such analysis is not comparable or meaningful given the differences in capital structures between the Company and the prior owners of the Properties and the impact of the Formation Transactions and the IPO on the Properties.

The historical property financial data presented in this report show significant increases in revenues and expenses principally attributable to the substantial portfolio growth. As a result, we do not believe the year-to-year financial data are comparable. Therefore, the analysis below shows changes resulting from Properties that the Predecessor owned as of January 1, 1997, excluding development projects (the "Same Store Properties"), and changes attributable to acquisition and development activity during 1997 and 1998. For the comparison between the years ended December 31, 1998 and 1997, the Same Store Properties consist of properties aggregating 31.1 million square feet. For the comparison between the years ended December 31, 1997 and 1996, the Same Store Properties consist of the 59 Properties acquired prior to January 1, 1996. Our future financial condition and results of operations, including rental revenues, may be impacted by the acquisition and divestiture of properties. Our future revenues and expenses may vary materially from their historical rates.

## **PROPERTIES – YEARS ENDED DECEMBER 31, 1998 AND 1997**

*Rental revenues.* Rental revenues, including straight-line rents, tenant reimbursements and other property related income, increased by \$72.0 million, or 25.5%, for the year ended December 31, 1998, to \$354.7 million, as compared with the same period in 1997. Approximately \$9.6 million, or 13.3%, of this increase was attributable to Same Store Properties, with the

remaining \$62.4 million attributable to Properties acquired in 1998. The growth in rental revenues in Same Store Properties resulted primarily from the incremental effect of rental rate increases and changes in occupancy and reimbursement of expenses. During the year ended December 31, 1998, the increase in average base rents (cash basis) was 14.3% on 7.7 million square feet leased.

*Property operating expenses and real estate taxes.* Property operating expenses, including asset management costs, increased by \$14.6 million, or 17.9%, for the year ended December 31, 1998, to \$96.1 million, as compared with the same period in 1997. Same Store Properties operating expenses decreased by approximately \$0.7 million for the year ended December 31, 1998, while operating expenses attributable to Properties acquired in 1998 amounted to \$15.3 million. The change in Same Store Properties operating expenses and real estate taxes relates to increases in Same Store Properties real estate taxes of approximately \$1.0 million, offset by decreases in Same Store Properties other property operating expenses, including insurance expenses and property management fees of approximately \$1.7 million. The remaining decrease in property operating expenses is primarily attributable to lower asset management costs in 1998 as compared to 1997 resulting from the change in ownership structure.

#### PROPERTIES – YEARS ENDED DECEMBER 31, 1997 AND 1996

*Rental revenues.* Rental income, including tenant reimbursements and other property related income, increased by \$67.5 million, or 40.6%, for the year ended December 31, 1997, to \$233.9 million as compared to \$166.4 million for the year ended December 31, 1996. Approximately \$8.8 million, or 13.0%, of this increase was attributable to the Same Store Properties, with the remaining \$58.7 million attributable to Properties acquired in 1997 and 1996. The 6.3% growth in rental income in the Same Store Properties resulted primarily from the incremental effect of rental rate increases and reimbursement of expenses. In 1997, we increased average contractual or base rental rates on the Properties by 12% on 393 new and renewing leases totaling 7.5 million rentable square feet (representing 17.2% of the Properties' aggregate rentable square footage).

*Property operating expenses and real estate taxes.* Property operating expenses and real estate taxes increased by \$25.6 million, or 46.3%, for the year ended December 31, 1997, to \$80.9 million as compared to \$55.3 million for the year ended December 31, 1996. Approximately \$3.4 million of this increase was attributable to the Same Store Properties, with the remaining \$22.2 million attributable to Properties acquired in 1997 and 1996. Same Store Properties real estate taxes and insurance expense increased by approximately \$1.4 million from 1996 to 1997. Same Store Properties other property operating expenses (excluding real estate taxes and insurance) increased by \$2.0 million from 1996 to 1997. The increases in expenses are primarily due to increases in property tax assessment values and incentive management fees expense.

### ***Liquidity and Capital Resources***

We currently expect that our principal sources of working capital and funding for acquisitions, development, expansion and renovation of the Properties will include cash flow from operations, borrowings under the Credit Facility, other forms of secured and unsecured financing, proceeds from equity or debt offerings by the Company or the Operating Partnership (including issuances of units in the Operating Partnership or its subsidiaries), and net proceeds from divestiture of properties. We presently believe that our sources of working capital and our ability to access private and public debt and equity capital are adequate for us to continue to meet liquidity requirements for the foreseeable future.

#### CAPITAL RESOURCES

*Property divestitures.* On March 9, 1999, we signed a series of definitive agreements with BPP Retail, LLC ("BPP Retail"), a co-investment entity between Burnham Pacific Properties ("BPP") and the California Public Employees' Retirement System ("CalPERS"), pursuant to which BPP Retail will acquire 28 of our retail shopping centers, totaling 5.1 million square feet, for an aggregate price of \$663.4 million. BPP Retail will acquire the centers in separate transactions, which we currently expect to close on or about April 30, 1999, July 31, 1999 and December 1, 1999. In addition, we have entered into a definitive agreement, subject to a financing

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confirmation, with BPP, pursuant to which BPP will acquire six additional retail centers, totaling 1.5 million square feet, for \$284.4 million. Assuming satisfaction or waiver of this condition, we currently expect this transaction to close by December 31, 1999. Assuming that the transactions with BPP Retail close as scheduled, the Company currently expects to reinvest approximately \$520 million in industrial properties and to reduce our secured indebtedness by approximately \$100 million. There can be no assurance, however, that the transactions will close as scheduled or close at all, and it is possible that the transactions may not close with respect to just one or more properties. In the event that one or more transactions fail to close, or a closing is significantly delayed, net proceeds from divestitures of properties will not be available to the same extent to fund our acquisitions and developments. Any such failure or delay in any of the closings may also make us unable to repay certain of our indebtedness with the net proceeds as we currently intend, and could require us to borrow additional funds or seek other forms of financing.

*Credit facility.* We have a \$500 million unsecured revolving credit agreement with Morgan Guaranty Trust Company of New York, as agent, and a syndicate of twelve other banks. The Credit Facility has a term of three years and is subject to a fee that accrues on the daily average undrawn funds, which varies between 15 and 25 basis points (currently 15 basis points) of the undrawn funds based on our credit rating. We use the Credit Facility principally for acquisitions and for general working capital requirements. Borrowings under the Credit Facility bear interest at LIBOR plus 90 to 120 basis points (currently LIBOR plus 90 basis points), depending on our debt rating at the time of the borrowings. As of December 31, 1998, the outstanding balance on the Credit Facility was \$234 million and bore interest at 6.10%. Monthly debt service payments on the Credit Facility are interest only. The Credit Facility matures in November 2000. The total amount available under the Credit Facility fluctuates based upon the borrowing base, as defined in the agreement governing the Credit Facility. At December 31, 1998, the remaining amount available under the Credit Facility was approximately \$266 million. We currently expect that the property divestitures will not materially affect the terms and conditions of the Credit Facility.

*Debt and equity financing.* In June 1998, the Operating Partnership issued \$400,000 aggregate principal amount of unsecured notes ("Senior Debt Securities") in an underwritten public offering, the net proceeds of which the Operating Partnership used to repay amounts outstanding under the Credit Facility. The Senior Debt Securities mature in June 2008, June 2015 and June 2018 and bear interest at a weighted average rate of 7.18%, which is payable in June and December of each year, commencing in December 1998. The 2015 notes are putable and callable in June 2005. We received credit ratings for the Senior Debt Securities of Baa1 from Moody's Investors Service, BBB from Standard & Poor's Corporation and BBB+ from Duff & Phelps Credit Rating Co. As a result of the receipt of these investment-grade credit ratings, the interest rate on the Credit Facility was reduced by 20 basis points to the current rate of LIBOR plus 90 basis points.

In July 1998, the Company sold 4,000,000 shares of 8½% Series A Cumulative Redeemable Preferred Stock at a price of \$25.00 per share in an underwritten public offering. These shares are redeemable solely at the option of the Company on or after July 27, 2003, subject to certain conditions. The Company contributed the net proceeds of \$96.1 million to the Operating Partnership in exchange for 4,000,000 Series A Preferred Units with terms identical to the Series A Preferred Stock. The Operating Partnership used the proceeds to repay borrowings under the Credit Facility incurred in connection with property acquisitions and for general purposes.

In November 1998, the Operating Partnership issued and sold 1,300,000 8.625% Series B Cumulative Redeemable Preferred Units at a price of \$50.00 per unit in a private placement. Distributions are cumulative from the date of original issuance and are payable quarterly in arrears at a rate per unit equal to \$4.3125 per annum. The Series B Preferred Units are redeemable by the Operating Partnership on or after November 12, 2003, subject to certain conditions, for cash at a redemption price equal to \$50.00 per unit, plus accumulated and unpaid distributions thereon, if any, to the redemption date. The Series B Preferred Units are exchangeable, at specified times and subject to certain conditions, on a one-for-one basis, for shares of the Company's Series B Preferred Stock. The Operating Partnership used the proceeds to repay borrowings under the Credit Facility, for property acquisitions and for general purposes.

In November 1998, a subsidiary of the Operating Partnership issued and sold 2,200,000 units of 8.75% Series C Cumulative Redeemable Preferred Units at a price of \$50.00 per unit in a private placement. Distributions are cumulative from the date of original issuance and are payable quarterly in arrears at a rate per unit equal to \$4.375 per annum. The Series C Preferred Units are redeemable by the subsidiary of the Operating Partnership on or after November 24, 2003, subject to certain conditions, for cash at a redemption price equal to \$50.00 per unit, plus accumulated and unpaid distributions thereon, if any, to the redemption date. The Series C Preferred Units are exchangeable, at specified times and subject to certain conditions, on a one-for-one basis, for shares of the Company's Series C Preferred Stock. The subsidiary of the Operating Partnership used the proceeds to make a loan to the Operating Partnership, which used the funds to repay borrowings under the Credit Facility.

*Market capitalization.* In connection with the Formation Transactions and property acquisitions consummated after the Formation Transactions, we have assumed various mortgages and other secured debt. As of December 31, 1998, the aggregate principal amount of this secured debt was \$719 million, excluding unamortized debt premiums of \$15.2 million. The secured debt bears interest at rates varying from 4.0% to 10.4% per annum (with a weighted average of 7.9%) and final maturity dates ranging from April 1999 to April 2014. We believe that the carrying value of the debt approximates its fair value on December 31, 1998.

In order to maintain financial flexibility and facilitate the rapid deployment of capital through market cycles, we presently intend to operate with a debt-to-total market capitalization ratio of approximately 45% or less. Additionally, we presently intend to continue to structure our balance sheet in order to maintain an investment grade rating on our senior unsecured debt.

The tables below summarize our debt maturities and capitalization as of December 31, 1998.

**Debt** (In thousands)

Year	Secured Debt	Unsecured Senior Debt Securities	Unsecured Credit Facility	Total Debt
1999	\$ 14,061	\$ -	\$ -	\$ 14,061
2000	19,833	-	234,000	253,833
2001	42,560	-	-	42,560
2002	68,849	-	-	68,849
2003	136,798	-	-	136,798
2004	67,396	-	-	67,396
2005	67,446	100,000	-	167,446
2006	131,759	-	-	131,759
2007	35,320	-	-	35,320
2008	114,425	175,000	-	289,425
Thereafter	20,532	125,000	-	145,532
Sub-total	718,979	400,000	234,000	1,352,979
Unamortized premiums	15,217	-	-	15,217
Total consolidated debt	\$ 734,196	\$ 400,000	\$ 234,000	1,368,196
Our share of unconsolidated JV debt				20,186
Total debt				1,388,382
JV Partner's share of consolidated JV debt				(40,275)
Our share of total debt				<u>\$1,348,107</u>

**Market Equity** (In thousands, except share amounts)

Security	Outstanding At 12/31/98	Market Price At 12/31/98	Market Value At 12/31/98
Common Stock	85,917,520	\$22.00	\$1,890,185
LP Units	4,447,839	22.00	97,853
Total	<u>90,365,359</u>		<u>\$1,988,038</u>

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## *Preferred Stock and Units* (In thousands, except percentages)

Security	Dividend Rate	Liquidation Preference	Redemption Provisions
Series A Preferred Stock	8.50%	\$100,000	July 2003
Series B Preferred Units	8.63%	65,000	November 2003
Series C Preferred Units	8.75%	110,000	November 2003
Total/Weighted Average	8.66%	\$275,000	

## *Capitalization Ratios*

Consolidated debt plus our share of unconsolidated JV debt-to-total market capitalization	38.0%
Consolidated debt plus our share of unconsolidated debt less JV partners' share of consolidated debt-to-total market capitalization	36.9%
Consolidated debt plus our share of unconsolidated JV debt plus preferred-to-total market capitalization	45.6%

## LIQUIDITY

As of December 31, 1998, we had approximately \$25.1 million in cash and cash equivalents and \$266 million of additional available borrowings under the Credit Facility. We intend to use cash flow from operations, borrowings under the Credit Facility, other forms of secured and unsecured financing, proceeds from equity or debt offerings by the Company or the Operating Partnership (including issuances of units in the Operating Partnership or its subsidiaries), and proceeds from divestiture of properties to fund acquisitions, development activities and capital expenditures and to provide for general working capital requirements.

On December 4, 1998, the Company and the Operating Partnership declared a quarterly cash distribution of \$0.3425 per common share and operating partnership unit, payable January 15, 1999 to stockholders and unitholders of record on December 31, 1998. The annual distribution per common share and unit for 1998 was \$1.37. On December 4, 1998, the Company declared a cash dividend of \$0.53125 per share on its Series A Preferred Stock, and the Operating Partnership declared a cash distribution of \$0.53125 per unit on its Series A Preferred Units, for the three month period ended January 14, 1999, payable on January 15, 1999 to stockholders and unitholders of record as of December 31, 1998. The 1998 dividend for the Series A Preferred Stock and Units was \$0.9917, for the partial year commencing on July 27, 1998, which was the issuance date.

On March 5, 1999, the Company and the Operating Partnership declared a quarterly cash distribution of \$0.35 per common share and operating partnership unit, for the quarter ending March 31, 1999, payable April 15, 1999 to stockholders and unitholders of record as of March 31, 1999. This dividend (with an annualized rate of \$1.40 per share) represents a 2.2% increase from the dividend for the fourth quarter and is consistent with our philosophy of retaining as much cash flow as allowed under the REIT tax rules while providing stockholders with dividend growth. On March 5, 1999, the Company declared a cash dividend of \$0.53125 per share on its Series A Preferred Stock, and the Operating Partnership declared a cash distribution of \$0.53125 per unit on its Series A Preferred Units, for the three month period ending April 14, 1999, payable on April 15, 1999 to stockholders and unitholders of record as of March 31, 1999.

The anticipated size of our distributions, using only cash from operations, will not allow us to retire all of our debt as it comes due. Therefore, we intend to also repay maturing debt with net proceeds from future debt and/or equity financings. However, we may not be able to obtain future financings on favorable terms or at all.

## CAPITAL COMMITMENTS

In addition to recurring capital expenditures and costs to renew or re-tenant space, as of December 31, 1998, our development pipeline included 18 projects representing a total estimated investment of \$349.9 million upon completion. Of this total, approximately \$156.0 million had been funded as of December 31,



1998, approximately \$66.2 million is estimated to be required to complete projects under construction as of December 31, 1998, and the remainder represents estimated investments in either projects where construction has not yet begun or future phases of projects under construction. We presently expect to fund these expenditures with cash flow from operations, borrowings under the Credit Facility, debt or equity issuances, and net proceeds from property divestiture. Other than these capital items, we have no material capital commitments.

During the period from January 1, 1998 to December 31, 1998, we invested:

- \$738.6 million in 228 industrial buildings, aggregating 18.8 million rentable square feet,
- \$31.8 million in 2 retail centers, aggregating 0.4 million rentable square feet,
- \$67.1 million in an unconsolidated limited partnership interest in an existing joint venture that owns 36 industrial buildings aggregating 4.0 million square feet.

We funded these acquisitions through borrowings under the Credit Facility, cash, debt assumption and the issuance of units in the Operating Partnership.

#### YEAR 2000 COMPLIANCE

*Our state of readiness.* We utilize a number of computer software programs and operating systems across our entire organization, including applications used in financial business systems and various administrative functions. To the extent that our software applications contain source code that is unable to appropriately interpret the upcoming calendar year "2000" and beyond, some level of modification or replacement of such applications will be necessary.

We are currently conducting a company-wide test of our financial and non-financial systems to ensure that our systems will adequately handle the year 2000 issue. Our current financial system generally provides for a four-digit year; however, the current system is not fully year 2000 compliant. We expect that our financial system will be fully year 2000 compliant once we complete a software upgrade in 1999. We are also currently surveying our property managers to determine if our non-financial systems (HVAC, security, lighting and other building systems) at our Properties are year 2000 compliant and to determine the state of readiness of our tenants regarding their year 2000 compliance.

*Costs of addressing our year 2000 issues.* Given the information known at this time about our systems, coupled with ongoing, normal course-of-business efforts to upgrade or replace critical systems, as necessary, we do not expect year 2000 compliance costs to have any material adverse impact on our liquidity or ongoing results of operations. The costs of such assessment and remediation will be included in our general and administrative expenses. Although we can make no assurance, we currently do not expect that the year 2000 issue will materially affect our operations due to problems encountered by our suppliers, customers and lenders.

*Risks of our year 2000 issues.* In light of our assessment and remediation efforts to date, we believe that any residual year 2000 risk is limited to non-critical business applications and support hardware. No assurance can be given, however, that all of our systems will be year 2000 compliant or that compliance will not have a material adverse effect on our future liquidity, results of operations or ability to service debt.

*Our contingency plans.* We are currently developing our contingency plan for all operations to address the most reasonably likely worst case scenarios regarding year 2000 compliance. We expect such contingency plan to be completed by the end of the year.

#### FUNDS FROM OPERATIONS

We believe that Funds from Operations ("FFO"), as defined by the National Association of Real Estate Investment Trusts ("NAREIT"), is an appropriate measure of performance for an equity REIT. While FFO is a relevant and widely used measure of operating performance of REITs, it does not represent cash flow from operations or net income as defined by GAAP, and it should not be considered as an alternative to those indicators in evaluating liquidity or operating performance. Further, FFO as disclosed by other REITs may not be comparable.

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The following table reflects the calculation of our FFO for the fiscal years ended December 31, 1997 and 1998. The 1997 FFO was prepared on a pro forma basis (giving effect to the completion of the Formation Transactions, the IPO and certain 1997 property acquisitions and divestitures) as if they had occurred on January 1, 1997.

(In thousands, except shares)	1997	1998
Income from operations before minority interests	\$103,903	\$123,750
Real estate depreciation and amortization:		
Total depreciation and amortization	45,886	57,464
Furniture, fixtures and equipment depreciation	(173)	(463)
FFO attributable to minority interests <sup>(1)(2)</sup>	(2,207)	(5,899)
Adjustments to derive FFO in unconsolidated joint venture <sup>(3)</sup> :		
Company's share of net income	-	(1,750)
Company's share of FFO	-	2,739
Series A preferred stock dividends	-	(3,639)
Series B & C preferred unit distributions	-	(1,795)
FFO <sup>(1)</sup>	<u>\$147,409</u>	<u>\$170,407</u>
Weighted average shares and units outstanding (diluted)	88,698,719	89,852,187

<sup>(1)</sup> Funds from Operations ("FFO") is defined as income from operations before minority interest, gains or losses from sale of real estate and extraordinary losses plus real estate depreciation and adjustment to derive our pro rata share of the FFO of unconsolidated joint ventures, less minority interests' pro rata share of the FFO of consolidated joint ventures and perpetual preferred stock dividends. In accordance with NAREIT White Paper on FFO, we include the effects of straight-line rents in FFO.

<sup>(2)</sup> Represents FFO attributable to minority interests in consolidated joint ventures for the periods presented, which has been computed as minority interests' share of net income before disposal of properties plus minority interests' share of real estate-related depreciation and amortization of the consolidated joint ventures for such periods. Such minority interests are not exchangeable into shares of Common Stock.

<sup>(3)</sup> Represents our pro rata share of FFO in unconsolidated joint ventures for the periods presented, which has been computed as our share of net income plus our share of real estate-related depreciation and amortization of the unconsolidated joint venture for such periods.

## QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company's exposure to market risk includes the rising interest rates in connection with the Company's unsecured credit facility and other variable-rate borrowings and the ability of the Company to incur more debt without stockholder approval, thereby increasing our debt service obligations, which could adversely affect the Company's cash flows. See "Liquidity and Capital Resources – Capital Resources – Market Capitalization."

# Consolidated Balance Sheets

AMB PROPERTY CORPORATION

	As of December 31,	
(In thousands, except share amounts)	1997	1998
<b>ASSETS</b>		
Investments in real estate:		
Land and improvements	\$ 550,635	\$ 740,680
Buildings and improvements	1,822,516	2,445,104
Construction in progress	69,848	183,276
Total investments in properties	2,442,999	3,369,060
Accumulated depreciation and amortization	(4,153)	(58,404)
Net investments in properties	2,438,846	3,310,656
Investment in unconsolidated joint venture	–	57,655
Properties held for divestiture, net	–	115,050
Net investments in real estate	2,438,846	3,483,361
Cash and cash equivalents	39,968	25,137
Other assets	27,441	54,387
Total assets	\$ 2,506,255	\$ 3,562,885
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Debt:		
Secured debt	\$ 535,652	\$ 734,196
Unsecured senior debt securities	–	400,000
Unsecured credit facility	150,000	234,000
Total debt	685,652	1,368,196
Other liabilities	49,350	104,305
Payable to affiliates	38,071	–
Total liabilities	773,073	1,472,501
Commitments and contingencies (note 11)	–	–
Minority interests	65,152	325,024
Stockholders' equity:		
Series A preferred stock, cumulative, redeemable, \$.01 par value, 100,000,000 shares authorized, 4,000,000 issued and outstanding, \$100,000 liquidation preference	–	96,100
Common stock, \$.01 par value, 500,000,000 shares authorized, 85,917,520 issued and outstanding	859	859
Additional paid-in capital	1,667,171	1,668,401
Retained earnings	–	–
Total stockholders' equity	1,668,030	1,765,360
Total liabilities and stockholders' equity	\$ 2,506,255	\$ 3,562,885

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

# Consolidated Statements of Operations

AMB PROPERTY CORPORATION

	For the Years Ended December 31,		
(In thousands, except share amounts)	1996	1997	1998
<b>REVENUES</b>			
Rental revenues	\$ —	\$ 26,465	\$ 354,658
Investment management and other income	23,991	29,597	4,229
Total revenues	23,991	56,062	358,887
<b>OPERATING EXPENSES</b>			
Property operating expenses	—	5,312	47,856
Real estate taxes	—	3,587	48,218
General and administrative	—	1,197	11,929
Interest, including amortization	—	3,528	69,670
Depreciation and amortization	—	4,195	57,464
Investment management expenses	16,851	19,358	—
Total operating expenses	16,851	37,177	235,137
Income from operations before minority interests	7,140	18,885	123,750
Minority interests' share of net income	(137)	(657)	(11,157)
Net income	\$ 7,003	\$ 18,228	\$ 112,593
Series A preferred stock dividends	—	—	(3,639)
Net income available to common stockholders	\$ 7,003	\$ 18,228	\$ 108,954
<b>INCOME PER SHARE OF COMMON STOCK</b>			
Basic	\$ 1.38	\$ 1.39	\$ 1.27
Diluted	\$ 1.38	\$ 1.38	\$ 1.26
<b>WEIGHTED AVERAGE COMMON SHARES OUTSTANDING</b>			
Basic	5,079,855	13,140,218	85,876,383
Diluted	5,079,855	13,168,036	86,235,176

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

# Consolidated Statements of Cash Flows

AMB PROPERTY CORPORATION

(In thousands)	For the Years Ended December 31,		
	1996	1997	1998
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Net Income	\$ 7,003	\$ 18,228	\$ 112,593
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	–	4,195	57,464
Straight-line rents	–	(901)	(10,921)
Amortization of debt premiums and financing costs	–	(266)	(2,730)
Minority interests' share of net income	137	657	11,157
Equity in (income) loss of AMB Investment Management	–	(61)	313
Equity earnings of unconsolidated joint venture	–	–	(1,730)
Changes in assets and liabilities:			
Other assets	(249)	(11,873)	(9,377)
Other liabilities	(25)	2,301	20,411
Net cash provided by operating activities	6,866	12,280	177,180
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Cash paid for property acquisitions	–	–	(564,304)
Additions to properties	–	(228,432)	–
Additions to buildings, development costs, and improvements	–	(4,375)	(137,913)
Acquisition of interest in unconsolidated joint venture	–	–	(67,376)
Distribution received from unconsolidated joint venture	–	–	11,451
Reduction of payable to affiliates in connection with Formation Transactions	–	–	(38,071)
Net cash used for investing activities	–	(232,807)	(796,213)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Issuance of common stock	–	317,009	–
Borrowings on unsecured credit facility	–	150,000	745,000
Borrowings on secured debt	–	850	58,725
Payment of unsecured credit facility	–	(182,000)	(661,000)
Payments on secured debt	–	(516)	(79,380)
Payment of financing fees	–	(900)	(7,704)
Net proceeds from issuance of senior debt securities	–	–	399,166
Net proceeds from issuance of Series A preferred stock	–	–	96,100
Net proceeds from issuance of Series B & C preferred units	–	–	167,993
Dividends paid to common stockholders and preferred stockholders	–	(11,506)	(88,236)
Dividends paid to Predecessor stockholders	(5,262)	(16,404)	–
Distributions to minority interests	(34)	–	(26,462)
Principal payment of notes receivable from stockholders of Predecessor	318	869	–
Net cash provided by (used in) financing activities	(4,978)	257,402	604,202
Net increase (decrease) in cash and cash equivalents	1,888	36,875	(14,831)
Cash and cash equivalents at beginning of period	1,205	3,093	39,968
Cash and cash equivalents at end of period	\$ 3,093	\$ 39,968	\$ 25,137

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

# Consolidated Statements of Stockholders' Equity

AMB PROPERTY CORPORATION

For the Years Ended December 31, 1996, 1997 and 1998

(In thousands, except share amounts)	Series A Preferred Stock	Common Stock		Additional Paid-in Capital	Retained Earnings	Notes Receivable From Stockholders	Total
		Number of Shares	Amount				
<b>PREDECESSOR</b>							
Balance at December 31, 1995	\$ -	5,079,855	\$1,042	\$ 1,298	\$ 2,781	\$(880)	\$ 4,241
Net Income	-	-	-	-	7,003	-	7,003
Dividends declared and paid	-	-	-	-	(5,262)	-	(5,262)
Principal payment of notes receivable from stockholders	-	-	-	-	-	318	318
Issuance of common stock for notes	-	101,595	307	-	-	(307)	-
Balance at December 31, 1996	-	5,181,450	1,349	1,298	4,522	(869)	6,300
<b>AMB PROPERTY CORPORATION</b>							
Net Income	-	-	-	-	18,228	-	18,228
Dividends declared and paid to Predecessor stockholders	-	-	(990)	(1,298)	(14,116)	-	(16,404)
Principal payment of notes receivable from stockholders	-	-	-	-	-	869	869
Exchange of Predecessor shares for shares of AMB Property Corporation, net	-	(434,834)	(312)	312	-	-	-
Issuance of common stock for Properties	-	65,022,185	651	1,369,740	-	-	1,370,391
Issuance of common stock, net of Offering costs of \$38,068	-	16,100,000	161	299,871	-	-	300,032
Issuance of restricted stock	-	5,712	-	120	-	-	120
Distributions paid to AMB Property Corporation stockholders	-	-	-	(2,872)	(8,634)	-	(11,506)
Balance at December 31, 1997	-	85,874,513	859	1,667,171	-	-	1,668,030
Net Income	3,639	-	-	-	108,954	-	112,593
Issuance of preferred stock, net of offering costs	96,100	-	-	-	-	-	96,100
Issuance of restricted stock	-	43,007	-	930	-	-	930
Reallocation of Limited Partners' interests in Operating Partnership	-	-	-	7,215	-	-	7,215
Dividends declared	(3,639)	-	-	(6,915)	(108,954)	-	(119,508)
<b>Balance at December 31, 1998</b>	<b>\$96,100</b>	<b>85,917,520</b>	<b>\$ 859</b>	<b>\$1,668,401</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$1,765,360</b>

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

# Notes to Consolidated Financial Statements

AMB PROPERTY CORPORATION

(In thousands, except share and square feet data)

## NOTE 1:

### **Organization and Formation of Company**

AMB Property Corporation, a Maryland corporation (the "Company"), commenced operations as a fully integrated real estate company effective with the completion of its initial public offering (the "IPO") on November 26, 1997. The Company elected to be taxed as a real estate investment trust ("REIT") under Sections 856 through 860 of the Internal Revenue Code of 1986 (the "Code"), commencing with its taxable year ended December 31, 1997, and believes its current organization and method of operation will enable it to maintain its status as a REIT. The Company, through its controlling interest in its subsidiary, AMB Property, L.P., a Delaware limited partnership (the "Operating Partnership"), is engaged in the acquisition, ownership, operation, management, renovation, expansion and development of industrial buildings and community shopping centers in target markets nationwide. Unless the context otherwise requires, the "Company" means AMB Property Corporation, the Operating Partnership and its other controlled subsidiaries.

The Company and the Operating Partnership were formed shortly before consummation of the IPO. AMB Institutional Realty Advisors, Inc., a California corporation and registered investment advisor (the "Predecessor") formed AMB Property Corporation, a wholly owned subsidiary, and merged with and into the Company (the "Merger") in exchange for 4,746,616 shares of the Company's Common Stock. In addition, the Company and the Operating Partnership acquired, through a series of mergers and other transactions, 31.8 million rentable square feet of industrial property and 6.3 million rentable square feet of retail property in exchange for 65,022,185 shares of the Company's Common Stock, 2,542,163 limited partner interests ("LP Units") in the Operating Partnership, the assumption of debt and, to a limited extent, cash. The net assets of the Predecessor and the properties acquired with Common Stock were contributed to the Operating Partnership in exchange for 69,768,801 LP Units. The purchase method of accounting was applied to the acquisition of the properties. Collectively, the Merger and the other formation transactions described above are referred to as the "Formation Transactions."

On November 26, 1997, the Company completed its IPO of 16,100,000 shares of Common Stock, \$0.01 par value per share (the "Common Stock"), for \$21.00

per share, resulting in gross offering proceeds of approximately \$338,100. The net proceeds of approximately \$300,032 were used to repay indebtedness, to purchase interests from certain investors who elected not to receive shares or units in connection with the Formation Transactions, to fund property acquisitions, and for general corporate working capital requirements.

As of December 31, 1998, the Company owned an approximate 95.1% general partner interest in the Operating Partnership. The remaining 4.9% limited partner interest is owned by nonaffiliated investors. For local law purposes, properties in certain states are owned through limited partnerships and limited liability companies owned 99% by the Operating Partnership and 1% by a wholly owned subsidiary of the Company. The ownership of such properties through such entities does not materially affect the Company's overall ownership of the interests in the properties. As the sole general partner of the Operating Partnership, the Company has the full, exclusive and complete responsibility and discretion in the day-to-day management and control of the Operating Partnership.

In connection with the Formation Transactions, the Operating Partnership formed AMB Investment Management, Inc., a Maryland corporation ("AMB Investment Management"). The Operating Partnership purchased 100% of AMB Investment Management's non-voting preferred stock (representing a 95% economic interest therein). Certain current and former executive officers of the Company and an officer of AMB Investment Management collectively purchased 100% of the Investment Management Subsidiary's voting common stock (representing a 5% economic interest therein). The Operating Partnership accounts for its investment in AMB Investment Management using the equity method of accounting. AMB Investment Management was formed to succeed to the Predecessor's investment management business of providing real estate investment management services on a fee basis to clients. The Operating Partnership also owns 100% of the non-voting preferred stock of Headlands Realty Corporation, a Maryland corporation (representing a 95% economic interest therein). Certain current and former executive officers of the Company and an officer of Headlands Realty Corporation collectively own 100% of the voting common stock of Headlands Realty Corporation (representing a 5% economic interest therein). Headlands Realty Corporation invests in properties and interests in entities that engage in the management, leasing and development of properties and similar activities.

# Notes to Consolidated Financial Statements

AMB PROPERTY CORPORATION

(In thousands, except share and square feet data)

As of December 31, 1998, the Company owned 582 industrial buildings (the "Industrial Properties") and 38 retail centers (the "Retail Properties") located in 30 markets throughout the United States. The Industrial Properties, principally warehouse distribution buildings, encompass approximately 56.6 million rentable square feet and, as of December 31, 1998, were 96.0% leased to over 1,600 tenants. The Retail Properties, principally grocer-anchored community shopping centers, encompass approximately 7.0 million rentable square feet and, as of the same date, were 94.6% leased to over 900 tenants. The Industrial Properties and the Retail Properties collectively are referred to as the "Properties."

## NOTE 2:

### **Summary of Significant Accounting Policies**

*Generally accepted accounting principles.* These consolidated financial statements have been prepared in accordance with generally accepted accounting principles using the accrual method of accounting. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

*Principles of consolidation.* The accompanying consolidated financial statements include the financial position, results of operations and cash flows of the Company, its wholly owned qualified REIT subsidiaries, the Operating Partnership, and twenty-one joint ventures (the "Joint Ventures") in which the Company has a controlling interest. The Company also has a 56.1% non-controlling limited partnership interest in one unconsolidated real estate joint venture which is accounted for under the equity method. Third-party equity interests in the Operating Partnership and the Joint Ventures are reflected as minority interests in the consolidated financial statements. All significant inter-company amounts have been eliminated.

*Basis of presentation.* The consolidated financial statements of the Company for 1997 include the results of operations of the Company, including property operations for the period from November 26, 1997

(the commencement of operations as a fully integrated real estate company) to December 31, 1997 and the results of the Company's Predecessor, an investment manager, for the period from January 1, 1997 to November 25, 1997. The consolidated financial statements for 1998 represent the results of operations of the Company for the year ended December 31, 1998.

*Investments in real estate.* Investments in real estate are stated at the lower of depreciated cost or net realizable value. Net realizable value for financial reporting purposes is reviewed for impairment on a property-by-property basis whenever events or changes in circumstances indicate that the carrying amount of a property may not be recoverable. Impairment is recognized when estimated expected future cash flows (undiscounted and without interest charges) are less than the carrying amount of the property. To the extent an impairment has occurred, the excess of the carrying amount of the property over its estimated fair value will be charged to income. As of December 31, 1998, we believe that there were no impairments of the carrying values of the Properties.

Depreciation and amortization are calculated using the straight-line method over the estimated useful lives of the investments. The estimated lives are as follows:

Land improvements	5 to 40 years
Buildings and improvements	5 to 40 years
Tenant improvements and leasing costs	Term of the related lease

The cost of buildings and improvements includes the purchase price of the property or interest in property, legal fees and acquisition costs, and interest, property taxes, and other costs incurred during the period of construction.

Expenditures for maintenance and repairs are charged to operations as incurred. Significant renovations or betterments that extend the economic useful life of assets are capitalized.

Project costs directly associated with the development and construction of a real estate project are capitalized as construction in progress. In addition, interest, real estate taxes and other costs are capitalized during the construction period.

*Cash and cash equivalents.* Cash and cash equivalents include cash held in financial institutions and other highly liquid short-term investments with original



maturities of three months or less. Cash and cash equivalents as of December 31, 1997 and 1998 include restricted cash of \$8,074 and \$5,227, respectively, which represents amounts held in escrow in connection with property purchases and capital improvements.

*Deferred financing.* Costs incurred in connection with financing are capitalized and amortized to interest expense on a straight-line basis (which approximates the effective interest method) over the term of the related loan. As of December 31, 1997 and 1998, deferred financing fees were \$871 and \$7,318, respectively, net of accumulated amortization of \$29 and \$772, respectively. Such amounts are included in Other Assets on the consolidated balance sheet.

*Fair value of financial instruments.* The Company's financial instruments include short-term investments, accounts receivable, accounts payable, accrued expenses, construction loans payable, mortgage debt, secured debt, senior debt securities, unsecured notes payable, and an unsecured credit facility. The fair value of these instruments approximates its carrying or contract values.

*Debt premiums.* In connection with the Formation Transactions, the Company assumed certain secured debt with an aggregate principal value of \$517,031 and a fair value of \$535,613. The difference between the principal value and the fair value was recorded as a debt premium. The debt premium is being amortized into interest expense over the term of the related debt instrument using the effective interest method. As of December 31, 1997 and 1998, the unamortized debt premium was \$18,286 and \$15,217, respectively.

*Minority interests.* Minority interests in the Company represent the limited partnership interests in the Operating Partnership and interests held by certain third parties in twenty-one real estate joint ventures that are consolidated for financial reporting purposes. Such investments are consolidated because 1) the Company owns a majority interest, or 2) the Company holds significant control over the entity through a 50% or greater ownership interest combined with the ability to control major operating decisions, such as approval of budgets, selection of property managers and change in financing.

The following table distinguishes the minority interest ownership held by certain Joint Venture Partners, Institutional Alliance Partners, the limited partners in

the Operating Partnership, the Series B Preferred Unit holders' interest in the Operating Partnership, and the Series C Preferred Unit holders' interest in a subsidiary of the Operating Partnership, as of and for the year ended December 31, 1998.

	Minority Interest Liability	Minority Interest Share of Net Income
Minority Interest –		
Joint Venture Partners	\$ 18,012	\$ 1,491
Minority Interest –		
Institutional Alliance Partners	52,381	2,987
Minority Interest –		
Limited Partners in the Operating Partnership	86,638	4,884
Minority Interest –		
Series B Preferred Units (liquidation preference of \$65,000)	62,259	779
Minority Interest –		
Series C Preferred Units (liquidation preference of \$110,000)	105,734	1,016
	<u>\$325,024</u>	<u>\$11,157</u>

*Revenues.* The Company, as a lessor, retains substantially all of the benefits and risks of ownership of the Properties and accounts for its leases as operating leases. Rental income is recognized on a straight-line basis over the term of the leases.

Reimbursements from tenants for real estate taxes and other recoverable operating expenses are recognized as revenue in the period the applicable expenses are incurred.

*Investment management and other income.* Investment management income consists primarily of professional fees generated from the Predecessors' real estate investment management services for periods prior to the Formation Transactions and the Company's equity in the earnings of AMB Investment Management for periods subsequent to the Formation Transactions. Other income consists primarily of interest income on cash and cash equivalents.

*Investment management expenses.* Investment management expenses represent the operating expenses of the Predecessor for periods prior to November 26, 1997 and consist of salaries and benefits and other management related expenses.

# Notes to Consolidated Financial Statements

AMB PROPERTY CORPORATION

(In thousands, except share and square feet data)

*Reclassifications.* Certain items in the consolidated financial statements for prior periods have been reclassified to conform with current classifications with no effect on results of operations.

NOTE 3:

**Transactions with  
Affiliates**

As discussed in Note 1, the Operating Partnership formed AMB Investment Management for the purpose of carrying on the operations of the Predecessor. The Company and AMB Investment Management have an agreement that allows for the sharing of certain costs and employees. Additionally, the Company provides AMB Investment Management with certain acquisition-related services.

As part of the Formation Transactions, the Operating Partnership was required to pay an amount equal to the net working capital balances at November 25, 1997 of the Predecessor and the acquired Properties to the owners of said entities. As of December 31, 1997, the Company owed approximately \$37,808 to owners related to these working capital distributions. Such amount was repaid in full in early 1998.

The Company and AMB Investment Management share common office space under lease obligations of an affiliate of the Predecessor. Such lease obligations are charged to the Company and AMB Investment Management at cost. For the years ended December 31, 1997, and 1998, the Company paid approximately \$700 and \$1,160, respectively, for occupancy costs related to the lease obligations of the affiliate.

NOTE 4:

**Property Held for  
Divestiture**

The Company has determined to focus exclusively on properties that meet its strategic objectives. Therefore, as of December 31, 1998, the Company had decided to divest itself of four industrial buildings and four retail centers. As of December 31, 1998, the divestiture of the properties is subject to negotiation of acceptable terms and other customary conditions.

The following summarizes the condensed results of operations of the properties held for divestiture for the period from November 26, 1997 to December 31, 1997 and for the year ended December 31, 1998:

	1997	1998
Income	\$ 1,406	\$14,851
Property operating expenses	370	3,626
Net operating income	<u>\$ 1,036</u>	<u>\$11,225</u>

As of December 31, 1998, the net carrying value of the properties held for divestiture was \$115,050, and two of the retail centers were encumbered by secured debt of \$42,615. The net proceeds will be used to acquire additional properties and pay down certain debts.

NOTE 5:

**Debt**

As of December 31, 1997 and 1998, debt, excluding unamortized debt premiums, consists of the following:

	1997	1998
Secured debt, varying coupon interest rates from 4.00% to 10.38%, due April 1999 to April 2014	\$ 517,366	\$ 718,979
Unsecured senior debt securities, weighted average interest rate of 7.18%, due June 2008, 2015, and 2018	-	400,000
Unsecured credit facility, variable interest at LIBOR plus 90 to 120 basis points (6.10% at December 31, 1998), due November 2000	150,000	234,000
Total Debt	<u>\$ 667,366</u>	<u>\$1,352,979</u>

Secured debt generally requires monthly principal and interest payments. The secured debt is secured by deeds of trust on certain Properties. As of December 31, 1998, the total gross investment value of those Properties secured by debt was \$1,458,652. All of the secured debt bear interest at fixed rates, except for two loans with an aggregate principal amount of \$9,155, which bear interest at a variable rate. The secured debt has various financial and non-financial covenants. Additionally, certain of the secured debt is cross-collateralized.

Interest on the senior debt securities is payable semiannually in each June and December commencing December 1998. The 2015 notes are puttable and callable

in June 2005. The senior debt securities are subject to various financial and non-financial covenants.

The Company has a \$500,000 unsecured revolving credit agreement (the "Credit Facility") with Morgan Guaranty Trust Company of New York, as agent, and a syndicate of twelve other banks. The Credit Facility has an original term of three years and is subject to a fee that accrues on the daily average undrawn funds, which varies between 15 and 25 basis points of the undrawn funds based on the Company's credit rating. The Credit Facility has various financial and non-financial covenants.

Capitalized interest related to construction projects for the period from November 26, 1997 to December 31, 1997, was \$448 and for the year ended December 31, 1998 was \$7,192. There was no capitalized interest for periods prior to the Formation Transactions.

The scheduled maturities of the Company's total debt, excluding unamortized debt premiums, as of December 31, 1998 are as follows:

	Secured Debt	Unsecured Senior Debt Securities	Unsecured Credit Facility	Total
1999	\$ 14,061	\$ -	\$ -	\$ 14,061
2000	19,833	-	234,000	253,833
2001	42,560	-	-	42,560
2002	68,849	-	-	68,849
2003	136,798	-	-	136,798
Thereafter	436,878	400,000	-	836,878
	<u>\$ 718,979</u>	<u>\$ 400,000</u>	<u>\$ 234,000</u>	<u>\$1,352,979</u>

NOTE 6:

**Leasing Activity**

Future minimum rental income due under non-cancelable leases with tenants in effect at December 31, 1998, is as follows:

1999	\$ 329,322
2000	287,771
2001	239,178
2002	189,259
2003	142,411
Thereafter	536,573
	<u>\$1,724,514</u>

In addition to minimum rental payments, certain tenants pay reimbursements for their pro rata share of specified operating expenses, which amounted to \$5,267 and \$68,071 for the period from November 26, 1997 to December 31, 1997 and for the year ended December 31,

1998, respectively. These amounts are included as rental income and operating expenses in the accompanying consolidated statements of operations. Certain of the leases also provide for the payment of additional rent based on a percentage of the tenant's revenues. For the period from November 26, 1997 to December 31, 1997 and for the year ended December 31, 1998, the Company recognized percentage rent revenues of \$185 and \$1,870, respectively. Some leases contain options to renew. No individual tenant accounts for greater than 2% of rental revenues.

NOTE 7:

**Income Taxes**

The Company elected to be taxed as a REIT under the Code commencing with its taxable year ended December 31, 1997. To qualify as a REIT, the Company must meet a number of organizational and operational requirements, including a requirement that it currently distribute at least 95% of its taxable income to its stockholders. It is management's intention to adhere to these requirements and maintain the Company's REIT status. As a REIT, the Company generally will not be subject to corporate level federal income tax on net income it distributes currently to its stockholders. As such, no provision for federal income taxes has been included in the accompanying consolidated financial statements. If the Company fails to qualify as a REIT in any taxable year, it will be subject to federal income taxes at regular corporate rates (including any applicable alternative minimum tax) and may not be able to qualify as a REIT for four subsequent taxable years. Even if the Company qualifies for taxation as a REIT, the Company may be subject to certain state and local taxes on its income and property and to federal income and excise taxes on its undistributed taxable income.

For the years ended December 31, 1997 and 1998, 0% of the dividends paid to common stockholders represented a return of capital for income tax purposes.

Prior to the Merger, the Predecessor conducted its business as an S corporation, and was not subject to federal income taxes under Subchapter S of the Internal Revenue Code. Under this election federal income taxes were paid by the stockholders of the Predecessor.

# Notes to Consolidated Financial Statements

AMB PROPERTY CORPORATION

(In thousands, except share and square feet data)

## NOTE 8:

### Stockholders' Equity

On July 27, 1998, the Company sold 4,000,000 shares of 8.5% Series A Cumulative Redeemable Preferred Stock at \$25.00 per share for \$100,000 in an underwritten public offering. These shares are redeemable solely at the option of the Company on or after July 27, 2003. The net proceeds of \$96,100 (after deducting underwriters' discounts and commissions and offering costs) from the offering were contributed to the Operating Partnership in exchange for 4,000,000 Series A preferred units with terms identical to the Series A Preferred Stock. The Operating Partnership used these proceeds to repay borrowings under the Credit Facility.

On December 4, 1998, the Company and the Operating Partnership declared a quarterly cash distribution of \$0.3425 per common share and operating partnership unit, payable on January 15, 1999 to stockholders of record on December 31, 1998. On December 4, 1998, the Company declared a cash dividend of \$0.53125 per share on its Series A Preferred Stock, and the Operating Partnership declared a cash distribution of \$0.53125 per unit of its Series A Preferred Units, payable on January 15, 1999 to stockholders and unit holders of record as of December 31, 1998.

## NOTE 9:

### Stock Incentive Plan and 401(k) Plan

*Stock incentive plan.* In November 1997, the Company established a Stock Option and Incentive Plan (the "Stock Incentive Plan") for the purpose of attracting and retaining eligible officers, directors and employees. The Company has reserved for issuance 5,750,000 shares of Common Stock under the Stock Incentive Plan. As of December 31, 1998, the Company had granted 4,384,037 non-qualified options, to certain directors, officers and employees. Each option is exchangeable for one share of the Company's Common Stock and has a weighted average exercise price equal to \$21.22. Each option's exercise price is equal to the Company's market price at the date of grant. The options had an original ten-year term and vest pro rata in annual installments over a three or four-year period from the date of grant.

The Company applies APB Opinion No. 25, "Accounting for Stock Issued to Employees" and related interpretations in accounting for its Stock Incentive Plan. Opinion 25 measures compensation cost using the

intrinsic value based method of accounting. Under this method, compensation cost is the excess, if any, of the quoted market price of the stock at the date of grant over the amount an employee must pay to acquire the stock. Accordingly, no compensation cost has been recognized for the Company's Stock Incentive Plan, as of December 31, 1998.

As permitted by SFAS 123, "Accounting for Stock-based Compensation", the Company has not changed its method of accounting for stock options but has provided the additional required disclosures. Had compensation cost for the Company's stock-based compensation plans been determined based on the fair value at the grant dates for awards under those plans consistent with the method of SFAS No. 123, the Company's pro forma net income available to common stockholders would have been reduced by \$1,767 and pro forma basic and diluted earnings per share would have been reduced to \$1.25 and \$1.24, respectively, for the year ended December 31, 1998.

The fair value of each option grant was estimated at the date of grant using the Black-Scholes option-pricing model with the following assumptions used for grants in 1997 and 1998, respectively: dividend yield of 6.52% and 6.31%, expected volatility of 18.75% and 23.10%, risk-free interest rate of 5.86% and 4.94%, and expected lives of 10 years for both years.

Following is a summary of the option activity for the years ended December 31, 1997 and 1998:

	Shares Under Option (000)	Weighted Average Exercise Price	Remaining Contractual Life
Outstanding, 11/25/97	-	-	-
Granted	3,154	\$21.00	10 years
Exercised	-	-	-
Forfeited	(10)	-	-
Outstanding, 12/31/97	3,144	21.00	10 years
Granted	1,508	21.69	10 years
Exercised	-	-	-
Forfeited	(268)	-	-
Outstanding, 12/31/98	4,384	21.40	9.4 years
Options exercisable at year-end	622	\$ 21.00	
Fair value of options granted during the year	\$2.43		

In 1997, under the Stock Incentive Plan, the Company sold 5,712 restricted shares of its Common Stock to certain independent directors for \$0.01 per share in cash. In 1998, under the Stock Incentive Plan, the Company issued 43,007 restricted shares to certain

officers of the Company as part of the Performance Pay Program. The restricted shares are subject to a repurchase right held by the Company, which lapses one-third of such shares annually. The repurchase right lapses fully on January 1, 2002.

*401(K) Plan.* In November 1997, the Company established a Section 401(k) Savings/Retirement Plan (the "Section 401(k) Plan"), which is a continuation of the Section 401(k) plan of the Predecessor, to cover eligible employees of the Company and any designated affiliate. The Section 401(k) Plan permits eligible employees of the Company to defer up to 10% of their annual compensation, subject to certain limitations imposed by the Code. The employees' elective deferrals are immediately vested and non-forfeitable upon contribution to the Section 401(k) Plan. The Company matches the employee contributions to the Section 401(k) Plan in an amount equal to 50% of the first 3.5% of annual compensation deferred by each employee and may also make discretionary contributions to the plan. As of December 31, 1997 and 1998, the Company's accrual for 401(k) match was \$140 and \$153, respectively. Such amounts were included in Other liabilities on the consolidated balance sheets.

Except for the Section 401(k) Plan, the Company offers no other post-retirement or post-employment benefits to its employees.

NOTE 10:

**Supplemental Information to  
Statement of Cash Flows**

	Years Ended December 31,		
	1996	1997	1998
Cash paid for interest	\$ -	\$ 2,509	\$ 68,209
Non-cash transactions:			
Acquisitions of properties	\$ -	\$ 2,438,634	\$ 901,284
Assumption of debt	-	(717,613)	(221,017)
Cash acquired	-	(43,978)	-
Other assumed assets and liabilities	-	(13,862)	-
Minority interest's contribution, including units issued	-	(64,358)	(115,963)
Shares issued	-	(1,370,391)	-
Net cash paid, net of cash acquired	\$ -	\$ 228,432	\$ 564,304

NOTE 11:

**Commitments and  
Contingencies**

*Litigation.* In the normal course of business, from time to time, the Company is involved in legal actions relating to the ownership and operations of its Properties. In management's opinion, the liabilities, if any, that may ultimately result from such legal actions are not expected to have a materially adverse effect on the consolidated financial position, results of operations, or cash flows of the Company.

*Environmental matters.* The Company follows the policy of monitoring its properties for the presence of hazardous or toxic substances. The Company is not aware of any environmental liability with respect to the Properties that would have a material adverse effect on the Company's business, assets or results of operations. There can be no assurance that such a material environmental liability does not exist. The existence of any such material environmental liability would have an adverse effect on the Company's results of operations and cash flow.

*General uninsured losses.* The Company carries comprehensive liability, fire, flood, environmental, extended coverage and rental loss insurance with policy specifications, limits and deductibles customarily carried for similar properties. There are, however, certain types of extraordinary losses that may be either uninsurable, or not economically insurable. Certain of the Properties are located in areas that are subject to earthquake activity; the Company has therefore obtained limited earthquake insurance. Should an uninsured loss occur, the Company could lose its investment in, and anticipated profits and cash flows, from a property.

# Notes to Consolidated Financial Statements

AMB PROPERTY CORPORATION  
(In thousands, except share and square feet data)

## NOTE 12:

### Quarterly Financial Data

Selected quarterly financial data for 1998 is as follows (unaudited):

	Quarter				Year
	March 31	June 30	September 30	December 31	
Revenues	\$ 75,785	\$ 85,014	\$ 94,061	\$104,027	\$358,887
Income from operations before minority interest	29,188	30,382	31,802	32,378	123,750
Minority interests' share of net income	(1,282)	(2,404)	(2,930)	(4,541)	(11,157)
Net income	\$ 27,906	\$ 27,978	\$ 28,872	\$ 27,837	\$112,593
Preferred stock dividends	—	—	(1,514)	(2,125)	(3,639)
Net income available to common stockholders	\$ 27,906	\$ 27,978	\$ 27,358	\$ 25,712	\$108,954
Net income per common share:					
Basic <sup>(1)</sup>	\$ 0.33	\$ 0.33	\$ 0.32	\$ 0.30	\$ 1.27
Diluted	\$ 0.32	\$ 0.32	\$ 0.32	\$ 0.30	\$ 1.26
Weighted average common shares outstanding:					
Basic	85,874,513	85,874,513	85,874,513	85,881,992	85,876,383
Diluted	86,284,736	86,222,175	86,251,857	86,181,937	86,235,176

<sup>(1)</sup>The sum of quarterly financial data varies from the annual data due to rounding.

## NOTE 13:

### Segment Information

The Company has two reportable segments: Industrial Properties and Retail Properties. The Company believes that the most relevant information about the way that its business is managed is through disclosure of certain data at the operating division level. The accounting policies of the segments are the same as those described in the summary of significant accounting policies. Significant information used by the Company for the reportable segments is as follows:

	Industrial Properties	Retail Properties	Total Properties
<b>Rental revenues</b>			
1996	\$ —	\$ —	\$ —
1997	16,898	9,567	26,465
1998	248,134	106,524	354,658
<b>Property net operating income and contribution to FFO<sup>(1)</sup></b>			
1996	—	—	—
1997	11,056	6,510	17,566
1998	181,832	76,752	258,584
<b>Investment in properties</b>			
1996	—	—	—
1997	1,639,321	803,678	2,442,999
1998 <sup>(2)</sup>	2,574,940	794,120	3,369,060

<sup>(1)</sup> Property net operating income (NOI) is defined as rental revenue, including reimbursements and straight-line rents, less property level operating expenses.

<sup>(2)</sup> Excludes net properties held for divestiture of \$115,050. See Note 4.

The Company uses property net operating income and FFO as operating performance measures. The following are reconciliations between total reportable segment revenue, property net operating income and funds from operations (“FFO”) contribution to consolidated revenues, net income and FFO:

	1996	1997	1998
<b>Revenues</b>			
Total rental revenues for reportable segments	\$ –	\$ 26,465	\$354,658
Investment management and other income	23,991	29,597	4,229
Total consolidated revenues	<u>\$ 23,991</u>	<u>\$ 56,062</u>	<u>\$358,887</u>
<b>Net Income</b>			
Property net operating income for reportable segments	\$ –	\$ 17,566	\$258,584
Investment management and other income	23,991	29,597	4,229
Less:			
General and administrative	–	1,197	11,929
Interest expense	–	3,528	69,670
Depreciation and amortization	–	4,195	57,464
Investment management expenses	16,851	19,358	–
Minority interests	137	657	11,157
Net income	<u>\$ 7,003</u>	<u>\$ 18,228</u>	<u>\$112,593</u>
<b>FFO<sup>(1)</sup></b>			
Net Income	\$ 7,003	\$ 18,228	\$112,593
Minority interests’ share of net income	137	657	11,157
Real estate depreciation and amortization:			
Total depreciation and amortization	–	4,195	57,464
Furniture, fixtures and equipment depreciation	–	(37)	(463)
FFO attributable to minority interests <sup>(2)</sup> :			
Institutional Alliance Partners	–	–	(3,828)
Other joint venture partners	–	(218)	(2,071)
Adjustments to derive FFO in unconsolidated joint venture <sup>(3)</sup> :			
Company’s share of net income	–	–	(1,750)
Company’s share of FFO	–	–	2,739
Preferred stock dividends	–	–	(3,639)
Series B & C preferred unit distributions	–	–	(1,795)
FFO	<u>\$ 7,140</u>	<u>\$ 22,825</u>	<u>\$170,407</u>

<sup>(1)</sup> Funds from Operations (“FFO”) is defined as income from operations before minority interest, gains or losses from sale of real estate and extraordinary losses plus real estate depreciation and adjustment to derive our pro rata share of the FFO of unconsolidated joint ventures, less minority interests’ pro rata share of the FFO of consolidated joint ventures and perpetual preferred stock dividends. In accordance with NAREIT White Paper on FFO, we include the effects of straight-line rents in FFO.

<sup>(2)</sup> Represents FFO attributable to minority interests in consolidated joint ventures for the periods presented, which has been computed as minority interests’ share of net income before disposal of properties plus minority interests’ share of real estate-related depreciation and amortization of the consolidated joint ventures for such periods. Such minority interests are not exchangeable into shares of Common Stock.

<sup>(3)</sup> Represents our pro rata share of FFO in unconsolidated joint ventures for the periods presented, which has been computed as our share of net income plus our share of real estate-related depreciation and amortization of the unconsolidated joint venture for such periods.

#### NOTE 14:

### **Subsequent Events**

(unaudited)

On March 5, 1999, the Company and the Operating Partnership declared a quarterly cash distribution of \$0.35 per common share and operating partnership unit, for the quarter ending March 31, 1999, payable April 15, 1999 to stockholders and unitholders of record as of March 31, 1999. On March 5, 1999, the Company declared a cash dividend of \$0.53125 per share on its Series A Preferred Stock, and the Operating Partnership declared a cash distribution of \$0.53125 per unit on its Series A Preferred Units, for the three month period ending April 14, 1999, payable on April 15, 1999 to stockholders and unitholders of record as of March 31, 1999.

On March 9, 1999, the Company signed a series of definitive agreements with BPP Retail, LLC (“BPP Retail”), a co-investment entity between Burnham Pacific

Properties (“BPP”) and the California Public Employees’ Retirement System (“CalPERS”), pursuant to which BPP Retail will acquire 28 retail shopping centers of the Company, totaling 5.1 million square feet, for an aggregate price of \$663.4 million. BPP Retail will acquire the centers in separate transactions, which are currently expected to close on or about April 30, 1999, July 31, 1999 and December 1, 1999. In addition, the Company has entered into a definitive agreement, subject to a financing confirmation, with BPP, pursuant to which BPP will acquire six additional retail centers, totaling 1.5 million square feet, for \$284.4 million. Assuming satisfaction or waiver of this condition, this transaction is currently expected to close by December 31, 1999. In connection with these transactions, the Company has also granted CalPERS an option to purchase up to 2,000,000 original issue shares of AMB’s Common Stock for an exercise price of \$25 per share that may be exercised on or before March 31, 2000.

# *Report of Independent Public Accountants*

## *To the Board of Directors of AMB Property Corporation:*

We have audited the accompanying consolidated balance sheets of AMB Property Corporation and subsidiaries as of December 31, 1998 and 1997, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 1998. These financial statements and the schedule referred to below are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and the schedule based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of AMB Property Corporation and subsidiaries as of December 31, 1998 and 1997, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1998, in conformity with generally accepted accounting principles.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The schedule listed in the index to the financial statements is presented for purposes of complying with the Securities and Exchange Commission's rules and is not a required part of the basic financial statements. This schedule has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, fairly states in all material respects the financial data required to be set forth therein in relation to the basic financial statements taken as a whole.



San Francisco, California  
February 2, 1999



# AMB Directors and Officers

AMB PROPERTY CORPORATION

## Independent Directors



Daniel H. Case, III  
President & CEO,  
Hambrecht & Quist Group



Robert H. Edelstein  
Co-Chairman,  
Fisher Center for Real Estate,  
UC Berkeley



Lynn M. Sedway  
Principal,  
Sedway Group



Jeffrey L. Skelton  
President & CEO,  
Symphony Asset Management



Thomas W. Tusher  
Former President & COO,  
Levi Strauss & Co.



Caryl B. Welborn  
Commercial Real Estate  
Attorney

## Executive Officers



Douglas D. Abbey\*  
Chairman, AMB Investment  
Management, Inc.



Hamid R. Moghadam\*  
President &  
Chief Executive Officer



T. Robert Burke\*  
Chairman of the Board



W. Blake Baird  
Chief Investment Officer,  
Managing Director



Luis A. Belmonte  
Managing Director  
Industrial Division



Michael A. Coke  
Chief Financial Officer,  
Senior Vice President



John H. Diserens  
Managing Director  
Retail Division



Bruce H. Freedman  
Managing Director  
Industrial Division



David S. Fries  
Chief Administration  
Officer, General Counsel,  
Managing Director



Barbara J. Linn  
President & Chief Executive  
Officer, AMB Investment  
Management, Inc.



John T. Roberts  
Director of Capital Markets,  
Senior Vice President



Craig A. Severance  
Managing Director  
New Initiatives & Technology

\*Director

# Shareholder Information

AMB PROPERTY CORPORATION

## Corporate Headquarters

AMB Property Corporation  
505 Montgomery Street, 5th Floor  
San Francisco, CA 94111  
Tel: 415-394-9000  
Fax: 415-394-9001

## Boston Office

AMB Property Corporation  
60 State Street, Suite 3700  
Boston, MA 02109  
Tel: 617-531-9000  
Fax: 617-531-9001

## Investor Relations & Shareholder Inquiries

Tel: 415-394-9000 ext. 250  
Fax: 415-394-9001  
E-mail: [ir@ambco.com](mailto:ir@ambco.com)

## Transfer Agent

Boston Equiserve  
1-800-730-6001

## Counsel

Latham & Watkins  
San Francisco, CA

## Auditors

Arthur Andersen LLP  
San Francisco, CA

## Stock Listing

New York Stock Exchange Symbol: AMB

## 10-K Report

A copy of the Company's Annual Report on Form 10-K as filed with the Securities and Exchange Commission may be obtained by contacting Investor Relations.

## AMB Website

<http://www.amb.com>

## News Releases

News releases can be viewed on our website.

## Annual Meeting

Shareholders of AMB Property Corporation are invited to attend the Annual Meeting of Shareholders, to be held at 9:00 a.m.

Friday, May 7, 1999

The Ritz Carlton, San Francisco  
600 Stockton at California Street  
Tel: 415-296-7465

## Professional Associations

International Council of Shopping Centers  
National Association of Industrial  
and Office Properties  
National Association of Real Estate  
Investment Managers  
National Association of Real Estate  
Investment Trusts  
National Council of Real Estate  
Investment Fiduciaries  
National Investor Relations Institute  
Pension Real Estate Association  
Real Estate Investment Advisory Council  
Society of Industrial and Office Realtors  
Urban Land Institute

## Market Information

The Company's initial public offering was completed in November 1997 at \$21 per share. Prior to November 1997, no public market existed for the Company's common stock.

The following table sets forth, for the periods indicated, the high and low closing prices for the Company's common stock as reported by the New York Stock Exchange.

Year Ended December 31,	High	Low
1997 (from November 21)	\$25 $\frac{5}{8}$	\$22 $\frac{1}{4}$
1998	\$25 $\frac{13}{16}$	\$20 $\frac{13}{16}$

**AMB:** **a commitment to  
shareholder value**

***AMB has distinguished itself as a leader by practicing shareholder-friendly corporate governance. All of our directors serve annual, not staggered, terms, and each of our six independent directors is compensated solely through annual stock option grants. Our goal is to ensure that the Company is managed in a way that maximizes value for all AMB shareholders. To that end, we have also chosen not to enact any poison pill or “shareholder rights” plan, and our corporate by-laws do not include the anti-takeover language usually adopted by other Maryland corporations. In addition, in March 1999, our Board of Directors adopted a provision that prohibits AMB from repricing stock options. Our approach is atypical, but our reasoning is simple: AMB is the property of its shareholders, and nothing should hinder a full and fair return on their investment.***



**AMB PROPERTY CORPORATION**  
Building Alliances. Building Value.™

505 Montgomery Street, 5th floor, San Francisco, CA 94111

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