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MISSION WEST PROPERTIES INC
Form 10-Q
November 02, 2004

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

Form 10-Q

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

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2004

COMMISSION FILE NUMBER 1-8383

MISSION WEST PROPERTIES, INC.
(Exact name of registrant as specified in its charter)

Maryland ----- (State or other jurisdiction of incorporation or organization)	95-2635431 ----- (I.R.S. Employer Identification Number)
--	---

10050 Bandley Drive
Cupertino, California 95014-2188
(Address of principal executive offices)

Registrant's telephone number, including area code is (408) 725-0700

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes [X] No []

APPLICABLE ONLY TO CORPORATE ISSUERS

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date:

18,077,191 shares outstanding as of November 1, 2004

MISSION WEST PROPERTIES, INC.

FORM 10-Q
FOR THE QUARTER ENDED SEPTEMBER 30, 2004

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PART I - FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

MISSION WEST PROPERTIES, INC.
CONSOLIDATED BALANCE SHEETS
(dollars in thousands, except share and per share amounts)
(Unaudited)

September 30, 2

ASSETS

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Real estate assets, at cost:	
Land	\$ 275,707
Buildings and improvements	779,558
Real estate related intangible assets	18,284

Total investments in properties	1,073,549
Less accumulated depreciation and amortization	(105,936)

Net investments in properties	967,613
Cash and cash equivalents	1,597
Restricted cash	1,551
Deferred rent receivable, net of \$2,000 allowance at September 30, 2004 and December 31, 2003	19,111
Investment in unconsolidated joint venture	2,431
Other assets (net of accumulated amortization of \$6,518 and \$4,211 at September 30, 2004 and December 31, 2003, respectively)	20,240

Total assets	\$1,012,543
	=====

LIABILITIES AND STOCKHOLDERS' EQUITY

Liabilities:	
Line of credit (related parties)	\$ 1,105
Revolving line of credit	26,492
Mortgage notes payable	295,284
Mortgage notes payable (related parties)	10,508
Interest payable	330
Security deposits	8,771
Deferred rental income	11,622
Dividend/distribution payable	25,076
Accounts payable and accrued expenses	8,482

Total liabilities	387,670
Commitments and contingencies	
Minority interests	511,777
Stockholders' equity:	
Preferred stock, \$.001 par value, 20,000,000 shares authorized, none issued and outstanding	-
Common stock, \$.001 par value, 200,000,000 shares authorized, 18,077,191 and 17,894,691 shares issued and outstanding at September 30, 2004 and December 31, 2003, respectively	18
Paid-in-capital	134,348
Accumulated deficit	(21,270)

Total stockholders' equity	113,096

Total liabilities and stockholders' equity	\$1,012,543
	=====

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

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(dollars in thousands, except share and per share amounts)

(Unaudited)

	Three months ended September 30, 2004	2003 (As Restated)
	-----	-----
Revenues:		
Rental revenue from real estate	\$29,580	\$33,310
Tenant reimbursements	3,766	4,796
Other income, including lease terminations, settlements and interest	397	567
	-----	-----
	33,743	38,673
	-----	-----
Expenses:		
Property operating, maintenance and real estate taxes	4,880	5,559
Interest	4,468	4,335
Interest (related parties)	256	280
General and administrative	395	360
Depreciation and amortization of real estate	5,428	5,497
	-----	-----
	15,427	16,031
	-----	-----
Income before equity in earnings of unconsolidated joint venture and minority interests	18,316	22,642
Equity in earnings of unconsolidated joint venture, including \$1,400 gain on sale of property acquired from related party in the nine months ended September 30, 2003	345	599
Minority interests	15,488	19,348
	-----	-----
Net income to common stockholders	\$ 3,173	\$ 3,893
	=====	=====
Net income to minority interests	\$15,488	\$19,348
	=====	=====
Net income per share to common stockholders:		
Basic	\$0.18	\$0.22
	=====	=====
Diluted	\$0.18	\$0.22
	=====	=====
Weighted average shares of common stock outstanding (basic)	18,071,484	17,747,293
	=====	=====
Weighted average shares of common stock outstanding (diluted)	18,098,174	17,817,917
	=====	=====

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

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MISSION WEST PROPERTIES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(dollars in thousands)
(Unaudited)

Cash flows from operating activities:

Net income

Adjustments to reconcile net income to net cash provided by operating activities:

Minority interests

Depreciation and amortization of real estate

Amortization of above market rent intangible asset

Equity in earnings of unconsolidated joint venture

Distributions from unconsolidated joint venture

Changes in operating assets and liabilities, net of liabilities assumed:

Deferred rent receivable

Other assets

Interest payable

Security deposits

Deferred rental income

Accounts payable and accrued expenses

Net cash provided by operating activities

Cash flows from investing activities:

Improvements to real estate assets

Purchase of real estate

Net proceeds from sale of TBI unconsolidated joint venture real estate

Net cash used in investing activities

Cash flows from financing activities:

Principal payments on mortgage notes payable

Proceeds from mortgage loan payable

Principal payments on mortgage notes payable (related parties)

Net payments under line of credit (related parties)

Payment on loan payable

Payment on revolving line of credit

Proceeds from revolving line of credit

Restricted bond

Financing costs

Proceeds from stock options exercised

Minority interest distributions

Dividends

Net cash used in/provided by financing activities

Net decrease/increase in cash and cash equivalents

Cash and cash equivalents, beginning of period

Cash and cash equivalents, ending of period

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Supplemental information:

Cash paid for interest

Supplemental schedule of non-cash investing and financing activities:

Issuance of common stock upon conversion of O.P units

Assumption of other liabilities in connection with property acquisition

Issuance of operating partnership units in connection with joint venture acquisition

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

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MISSION WEST PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except share, per share, O.P units and per square footage amounts)

(Unaudited)

The Company's consolidated financial statements have been prepared pursuant to the Securities and Exchange Commission's ("SEC") rules and regulations. The following notes, which present interim disclosures as required by the SEC, highlight significant changes to the notes to the Company's December 31, 2003 audited consolidated financial statements and should be read together with the financial statements and notes thereto included in the Company's Form 10-K. The results of operations for the three and nine months ended September 30, 2004 are not necessarily indicative of the results to be expected for the entire year.

1. ORGANIZATION AND FORMATION OF THE COMPANY

Mission West Properties, Inc. ("the Company") is a fully integrated, self-administered and self-managed real estate company that acquires and manages R&D/office properties in the portion of the San Francisco Bay Area commonly referred to as Silicon Valley. In July 1998, the Company purchased an approximate 12.11% of four existing limited partnerships (referred to collectively as the "operating partnerships") and obtained control of these partnerships by becoming the sole general partner in each one effective July 1, 1998 for financial accounting and reporting purposes. The Company purchased an approximate 12.11% interest in each of the operating partnerships. All limited partnership interests in the operating partnerships were converted into 59,479,633 operating partnership ("O.P.") units, which represented a limited partnership ownership interest of approximately 87.89% of the operating partnerships. The operating partnerships are the vehicles through which the Company holds its real estate investments, makes real estate acquisitions, and generally conducts its business.

On December 30, 1998, the Company was reincorporated under the laws of the State of Maryland through a merger with and into Mission West Properties, Inc. Accordingly, shares of the former company, Mission West Properties, a California corporation (no par), which were outstanding at December 30, 1998, were converted into shares of common stock (\$.001 par value per share) on a one-for-one basis.

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As of September 30, 2004, the Company owns a general partnership interest of 17.12%, 21.63%, 16.14% and 12.38% in Mission West Properties, L.P., Mission West Properties, L.P. I, Mission West Properties, L.P. II and Mission West Properties, L.P. III, respectively, for a 17.30% general partnership interest in the operating partnerships, taken as a whole, on a weighted average basis.

Through the operating partnerships, the Company owns interests in 109 R&D properties, all of which are located in Silicon Valley.

The Company has elected to be taxed as a real estate investment trust ("REIT") under the Internal Revenue Code of 1986, as amended. Accordingly, no provision has been made for income taxes for the three and nine months ended September 30, 2004.

BUSINESS SEGMENT INFORMATION

The Company's primary business is the ownership and management of R&D/office real estate with a geographic concentration in the Silicon Valley of the San Francisco Bay Area. Accordingly, the Company has concluded it currently has a single reportable segment for SFAS No. 131 purposes.

2. BASIS OF PRESENTATION

PRINCIPLES OF CONSOLIDATION AND FINANCIAL STATEMENT PRESENTATION

The accompanying consolidated financial statements include the accounts of Mission West Properties, Inc. and its controlled subsidiaries, including the operating partnerships. All significant intercompany balances have been eliminated in consolidation. The consolidated financial statements as of and for the three and nine months ended September 30, 2004 and 2003 and related footnote disclosures are unaudited. In the opinion of management, such financial statements reflect all adjustments necessary for a fair presentation of the results of the interim periods. All such adjustments are of a normal recurring nature.

MINORITY INTERESTS

Minority interest represents the separate private ownership of the operating partnerships by the Berg Group (defined as Carl E. Berg, his brother Clyde J. Berg, members of their respective immediate families, and certain entities they control) and other non-affiliate interests. In total, these interests account for approximately 83% of the ownership interests in the real estate operations of the Company as of September 30, 2004. Minority interest in net income is calculated by taking the net income of the operating partnerships (on a stand-alone basis) multiplied by the respective minority interest ownership percentage.

RECLASSIFICATIONS

Certain reclassifications have been made to the previously reported 2003 statements in order to conform to the 2004 presentation.

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ACCOUNTING FOR STOCK-BASED COMPENSATION

SFAS No. 123, "Accounting for Stock-Based Compensation," encourages, but does not require companies to record compensation cost for stock-based employee compensation plans at fair value. The Company has chosen to continue to account for stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board Opinion ("APB") No. 25, "Accounting for Stock Issued to Employees" and related interpretations.

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Accordingly, compensation cost for stock options is measured as the excess, if any, of the quoted market price of the Company's stock at the date of the grant over the amount an employee must pay to acquire the stock.

The following table illustrates the unaudited pro forma effect on consolidated net income available to common shareholders and consolidated earnings per share if the fair value method had been applied to all outstanding and unvested stock options for the three and nine months ended September 30, 2004 and 2003.

	Three Months Ended September 30, 2004	2003 (As Restated)	
	-----	-----	-----
	(dollars in thousands, e		
Historical net income to common stockholders	\$3,173	\$3,893	
Deduct compensation expense for stock options determined under fair value based method	(44)	(59)	
Allocation of expense to minority interest	36	49	
	-----	-----	-----
Pro forma net income to common stockholders	\$3,165	\$3,883	=====
	=====	=====	=====
 Earnings per share - basic:			
Historical net income to common stockholders	\$0.18	\$0.22	
Pro forma net income to common stockholders	\$0.18	\$0.22	
 Earnings per share - diluted:			
Historical net income to common stockholders	\$0.18	\$0.22	
Pro forma net income to common stockholders	\$0.17	\$0.22	

No stock options were granted during the first nine months of 2004.

3. STOCK TRANSACTIONS

During the nine months ended September 30, 2004, stock options to purchase 20,000 shares of common stock were exercised at \$8.25 per share. Total proceeds to the Company were approximately \$165. In 2004, two limited partners exchanged 104,500 O.P. units for 104,500 shares of the Company's common stock under the terms of the December 1998 Exchange Rights Agreement among the Company and all limited partners of the operating partnerships. In 2004, Carl E. Berg gave 58,000 O.P. units to charitable institutions that exchanged them for 58,000 shares of the Company's common stock pursuant to the December 1998 Exchange Rights Agreement.

4. NET INCOME PER SHARE

Basic operating net income per share is computed by dividing net income by the weighted average number of common shares outstanding for the period. Diluted operating net income per share is computed by dividing net income by the sum of the weighted-average number of common shares outstanding for the period plus the assumed exercise of all dilutive securities using the treasury stock method.

The computation for weighted average shares is detailed below:

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	Three Months Ended September 30, 2004	2003
	-----	-----
Weighted average shares outstanding (basic)	18,071,484	17,747,293
Incremental shares from assumed option exercise	26,690	70,624
	-----	-----
Weighted average shares outstanding (diluted)	18,098,174	17,817,917
	=====	=====

The outstanding O.P. units, which are exchangeable at the unit holder's option, subject to certain conditions, for shares of common stock on a one-for-one basis have been excluded from the diluted net income per share calculation, as there would be no effect on the calculation after adding the minority interests' share of income back to net income. The total number of O.P. units outstanding at September 30, 2004 and 2003 was 86,404,695 and 86,498,064, respectively.

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5. RELATED PARTY TRANSACTIONS

As of September 30, 2004, the Berg Group owned 77,577,528 O.P. units. The Berg Group's ownership as of September 30, 2004 represented approximately 74% of the equity interests, assuming conversion of the 86,404,695 O.P. units outstanding into the Company's common stock.

The Berg Group \$20,000 line of credit bears interest at LIBOR plus 1.30%, which was 3.47% as of September 30, 2004, and matures in March 2005. The Company believes that the terms of the Berg Group line of credit are more favorable than those available from commercial lenders. As of September 30, 2004, debt in the amount of \$1,105 was due the Berg Group under the line of credit, and debt in the amount of \$10,508 was due the Berg Group under a mortgage note established May 15, 2000 in connection with the acquisition of a 50% interest in Hellyer Avenue Limited Partnership, the obligor under the mortgage note. The mortgage note bears interest at 7.65% and is due June 2010 with principal payments amortized over 20 years. Interest expense incurred in connection with the Berg Group line of credit and mortgage note was \$256 and \$280 for the three months ended September 30, 2004 and 2003, respectively, and \$760 and \$830 for the nine months ended September 30, 2004 and 2003, respectively.

During the first nine months of 2004 and 2003, Carl E. Berg or entities controlled by Mr. Berg held financial interests in several companies that lease space from the operating partnerships, which include three companies where Mr. Berg has a greater than 10% ownership interest. These related tenants occupy approximately 48,000 square feet and contributed \$217 and \$229 in rental revenue during the three months ended September 30, 2004 and 2003, respectively, and \$650 and \$687 in rental revenue during the first nine months of 2004 and 2003, respectively. Under the Company's charter, bylaws and agreements with the Berg Group, the individual members of the Berg Group are prohibited from acquiring shares of the Company's common stock if such acquisition would result in their beneficial ownership percentage of the Company's common stock causing the Company to violate any REIT qualification requirement.

The Berg Group has an approximately \$2,500 commitment to complete certain tenant improvements in connection with the Company's 2002 acquisition of 5345 Hellyer Avenue in San Jose. The Company recorded this portion of its

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purchase consideration paid to the Berg Group as an Other Asset on its Consolidated Balance Sheets. The Berg Group plans to satisfy this commitment to complete certain tenant improvements when requested by the Company following the approval of the Independent Directors Committee of the Company's board of directors (the "Independent Directors Committee").

The Berg Group has an approximately \$7,500 commitment to complete an approximately 75,000 to 90,000 square foot building in connection with the Company's 2001 acquisition of 245 Caspian in Sunnyvale which is comprised of approximately three acres of unimproved land. The Company recorded this portion of its purchase consideration paid to the Berg Group as an Other Asset on its Consolidated Balance Sheets. The Berg Group plans to satisfy this commitment to construct a building when requested by the Company following the approval of the Independent Directors Committee.

The Company currently leases office space owned by Berg & Berg Enterprises, Inc., an affiliate of Carl E. Berg and Clyde J. Berg. Rental amounts and overhead reimbursements paid to Berg & Berg Enterprises, Inc. were \$23 for each of the three-month periods ended September 30, 2004 and 2003 and \$68 for each of the nine-month periods ended September 30, 2004 and 2003.

In January 2003, the Company acquired a 50% interest in an unconsolidated joint venture from the Berg Group under the Berg Land Holdings Option Agreement for \$1,800. The Company financed this acquisition by issuing 181,032 O.P. units to various members of the Berg Group. In April 2003, the Company, through the joint venture, acquired a property from the Berg Group under the Berg Land Holdings Agreement and sold it to an unrelated third party. The Company received a net distribution and recorded a gain of \$1,400 from the sale.

6. COMMITMENTS AND CONTINGENCIES

Neither the operating partnerships, the properties nor the Company are subject to any material litigation nor, to the Company's knowledge, is any material litigation threatened against the operating partnerships, the properties or the Company. From time to time, the Company is engaged in legal proceedings arising in the ordinary course of business. The Company does not expect any of such proceedings to have a material adverse effect on its cash flows, financial condition or results of operations. The Company is currently involved in or has recently concluded the following legal proceedings, which it believes the ultimate outcome will have no material adverse effect on its consolidated financial statements.

Republic Properties Corporation ("RPC") v. Mission West Properties, L.P. ("MWP"), in the Circuit Court of Maryland for Baltimore City Case No. 24-C-00-005675. RPC is a former partner with Mission West Properties, L.P. in the Hellyer Avenue Limited Partnership ("Hellyer LP"). In April 2004, the Circuit Court for Baltimore City, Maryland issued a Memorandum Opinion in the case and awarded damages of approximately \$934 to the RPC plaintiffs, which must be paid by the Company or MWP. The court denied all requests by MWP, including a declaration that all of RPC's interests in Heller L.P. were validly converted to limited partnership interests and transferred to MWP or its designee in accordance with the terms of the Hellyer L.P. partnership agreement. The court also denied RPC's request for an injunction ordering the reinstatement of RPC's partnership interests in Hellyer L.P. The Company has appealed the decision to the Maryland Appeals Court. Under the pre-appeal hearing procedures, the Maryland Appeals Court requires a mediation hearing before the parties can appear before the Appeals Court. No date has been set for such a

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hearing. The Company does not believe that any further court decisions in this case, for or against it and MWP, will have a material adverse effect on its business. The Company has a receivable from a Berg Group affiliate for the amount of distributions it received as the successor to RPC's interest in the Hellyer LP which exceeds the amount of the damages awarded to the RPC parties and would be used to pay for those damages in the event the decision of the Circuit Court is upheld ultimately. Furthermore, the Company has never accounted for the 50% interest of RPC as its asset and if RPC is deemed to have retained that interest or reacquires that interest, the Company's balance sheet and financial condition would not be impacted. In February 2001, the Company filed a suit against RPC in Superior Court of the State of California for the County of Santa Clara Case No. CV 796249 which has been stayed pending resolution of the Maryland case. In July 2004, RPC attached the Company's bank account for approximately \$1,100. Following a July 2004 hearing in Superior Court of the State of California for the County of Santa Clara, the Company posted a \$1,551 bond in August 2004 and RPC removed the attachment on the Company's bank account until final resolution of the appeal in Maryland.

In January 2004, the Global Crossing Estate Representative, for Itself and the Liquidating Trustee of the Global Crossing Liquidating Trust v. Mission West Properties filed an action in United States Bankruptcy Court Southern District of New York Case No. 02-40188 (REG) asserting that payments of approximately \$815 made in the ordinary course of business within 90 days of the Global Crossing bankruptcy filing were preference payments. The Company has engaged legal counsel to defend itself in this claim and intend to vigorously contest the matter.

In December 2003, Craig R. Jalbert Liquidating CEO, as representative of the Estate of the Consolidated Debtors for ACT Manufacturing, Inc v. Mission West Properties, L.P. filed an action in United States Bankruptcy Court District of Massachusetts Case No. 01-47641 (JBR) asserting that payments of approximately \$482 made in the ordinary course of business within 90 days of the ACT bankruptcy filing were preference payments. The Company has engaged legal counsel to defend itself in this claim and intend to vigorously contest the matter.

GUARANTEES

Under its certificate of incorporation and bylaws, the Company has agreed to indemnify its officers and directors for certain events or occurrences arising as a result of the officer or director's serving in such capacity. The maximum potential amount of future payments the Company could be required to make under these indemnification agreements is unlimited. The Company believes the estimated fair value of these indemnification agreements is minimal and has no liabilities recorded for these agreements as of September 30, 2004.

The Company also enters into indemnification provisions under (i) its agreements with other companies in its ordinary course of business, typically with lenders, joint venture partners, contractors, and tenants. Under these provisions the Company generally indemnifies and holds harmless the indemnified party for losses suffered or incurred by the indemnified party as a result of the Company's activities. These indemnification provisions generally survive termination of the underlying agreement. The maximum potential amount of future payments the Company could be required to make under these indemnification provisions is unlimited. The Company has not incurred material costs to defend lawsuits or settle claims related to these indemnification agreements. As a result, the Company believes the estimated fair value of these agreements is minimal. Accordingly, the Company has no liabilities recorded for these agreements as of September 30, 2004.

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SEISMIC ACTIVITY

The Company's properties are located in an active seismic area of Silicon Valley. Insurance policies currently maintained by the Company do not cover seismic activity, although they do cover losses from fires after an earthquake.

ENVIRONMENTAL ISSUES

The environmental investigations that have been conducted on the Company's properties have not revealed any environmental liability that it believes would have a material adverse effect on its financial condition, results of operations and assets, and it is not aware of any such liability. Nonetheless, it is possible that there are material environmental liabilities of which the Company is unaware. The Company cannot assure that future laws, ordinances, or regulations will not impose any material environmental liability, or that the current environmental condition of the properties has not been, or will not be, affected by tenants and occupants of the properties, by the condition of properties in the vicinity of the properties, or by third parties unrelated to the Company.

7. RESTATEMENTS

The Company has restated its previously reported quarterly information for the three and nine months ended September 30, 2003. The restated consolidated financial statements were reported and are further discussed in the Company's 2003 Form 10-K filed on July 30, 2004. The items that the Company restated for are as follows:

- The Company recorded additional amortization expense relating to certain leasing commissions, which were originally being amortized over a 40-year period. The additional amortization expense resulted from changing the amortization period of commissions from 40 years to the term of the lease and the write-off of certain unamortized leasing commissions in connection with tenant bankruptcies.

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- The Company corrected the purchase accounting originally applied to its 2002 acquisition of the Orchard-Trimble property. In accordance with Statement of Financial Accounting Standards (SFAS) No. 141, Business Combinations, which became effective July 1, 2001, the Company allocated a portion of the purchase price to in-place lease intangible assets and recorded additional amortization expense from changing the amortization period of these intangible assets from 40 years to the term of the lease.
- The Company recorded additional depreciation expense relating to the reclassification of certain real estate assets from a 40-year depreciable life to a 7- and 25-year depreciable life.
- The Company reclassified the amortization of the above-market lease intangible asset relating to the 2003 acquisition of the San Thomas Technology Park from amortization expense to an offset to rental revenue from real estate.

The aggregate net impact of all restatement items on the Company's Consolidated Statements of Operations for the three and nine months ended September 30, 2003 resulted in a decrease in net income to common stockholders compared to previously reported amounts of \$50 (\$0.00 per diluted share) and \$139 (\$0.01 per diluted share), respectively. The effects of the restatement items described above on the Company's net income to common stockholders for the three and nine months ended September 30, 2003 are as follows:

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	Three Months Ended September 30, 2003	Nine Months September 30
	----- (dollars in thousands) -----	
Net income to common stockholders, as previously reported	\$3,943	\$12,132
Impact of adjustments for:		
Leasing commission amortization	(128)	(384)
Intangible asset amortization	(137)	(410)
Depreciation of real estate assets	(35)	(49)
	-----	-----
Total adjustments	(300)	(843)
	-----	-----
Minority interest portion of adjustments	250	704
	-----	-----
Net income to common stockholders, as restated	\$3,893	\$11,993
	=====	=====

8. SUBSEQUENT EVENTS

On October 7, 2004, the Company paid dividends of \$0.24 per share of common stock to all common stockholders of record as of September 30, 2004. On the same date, the operating partnerships paid a distribution of \$0.24 per O.P. unit to all holders of O.P. units.

On October 14, 2004, the Company concluded the renewal and extension of its \$80,000 mortgage term loan with Citicorp USA, Inc. (the "Citicorp Loan") for an additional two years until September 6, 2006. The Citicorp Loan requires monthly principal payments of \$215 and carries a variable interest rate of LIBOR plus 2%. The loan fee and costs incurred in connection with the mortgage loan extension amounted to approximately \$142 and will be amortized over the two-year term of the loan using the interest method. Under the previous loan terms Carl E. Berg had personally guaranteed the Company's repayment obligations and provided a personal guaranty of the Company's obligation to indemnify the lender for certain potential environmental liabilities with respect to the pledged properties. Those guaranties were provided in conjunction with Citicorp's short-term loan of \$80,000 for the Company's acquisition of the San Tomas Technology Park and were released by Citicorp as part of the loan renewal and extension. The loan is secured by seven properties owned by the Company. The Citicorp Loan terms require the Company to maintain a minimum excess of assets over liabilities of \$400,000.

On October 14, 2004, in connection with the Company's extension of the Citicorp Loan, the Company retired an 8.75% mortgage loan from Prudential Capital Group with \$548 of outstanding principal, which was collateralized by one property located at 20400 Mariani Avenue in Cupertino, California. This property has been added as additional security for the Citicorp Loan.

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OF OPERATIONS

This Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the accompanying consolidated financial statements and notes thereto contained herein and our consolidated financial statements and notes thereto contained in our Annual Report on Form 10-K as of and for the year ended December 31, 2003. The results for the three and nine months ended September 30, 2004 are not necessarily indicative of the results to be expected for the entire fiscal year ending December 31, 2004. The following discussion includes forward-looking statements, including but not limited to, statements with respect to our future financial performance, operating results, plans and objectives. Actual results may differ materially from those currently anticipated depending upon a variety of factors, including those described under the sub-heading, "Forward-Looking Information."

FORWARD-LOOKING INFORMATION

This quarterly report contains forward-looking statements within the meaning of the federal securities laws. We intend such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Reform Act of 1995, and is including this statement for purposes of complying with these safe harbor provisions. Forward-looking statements, which are based on certain assumptions and describe future plans, strategies and expectations of the Company, are generally identifiable by use of the words "believe," "expect," "intend," "anticipate," "estimate," "project" or similar expressions. Additionally, all disclosures under Part I, Item 3 constitute forward-looking statements. Our ability to predict results or the actual effect of future plans or strategies is inherently uncertain.

Factors that could have a material adverse effect on our operations and future prospects include, but are not limited to, the following:

- economic conditions generally and the real estate market specifically,
- legislative or regulatory provisions (including changes to laws governing the taxation of REITs),
- availability of capital,
- interest rates,
- competition,
- supply of and demand for R&D, office and industrial properties in our current and proposed market areas,
- tenant defaults and bankruptcies,
- lease term expirations and renewals, and
- general accounting principles, policies and guidelines applicable to REITs.

In addition, the actual timing of development, construction, and leasing on any projects that we believe we may acquire in the future under the Berg Land Holdings Option Agreement is presently unknown, and reliance should not be placed on the estimates concerning these projects. These risks and uncertainties, together with the other risks described from time to time in our reports and other documents filed with the Securities and Exchange Commission, should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements.

OVERVIEW

We acquire, market, lease, and manage R&D/office properties, primarily located in the Silicon Valley portion of the San Francisco Bay Area. As of September 30, 2004, we owned and managed 109 properties totaling approximately 7.9 million rentable square feet through four limited partnerships, or operating partnerships, for which we are the sole general partner. This class of property is designed for research and development and office uses and, in some cases,

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includes space for light manufacturing operations with loading docks. We believe that we have one of the largest portfolios of R&D/office properties in the Silicon Valley. As of September 30, 2004, the six tenants who each leased in excess of 300,000 rentable square feet from us were Microsoft Corporation, Fujitsu America (a subsidiary of Fujitsu Limited), JDS Uniphase Corporation, NEC Electronics America, Inc. (a subsidiary of NEC Electronics Corporation), Ciena Corporation and Apple Computer, Inc. For federal income tax purposes, we have operated as a self-managed, self-administered and fully integrated real estate investment trust ("REIT") since fiscal 1999.

Our acquisition, growth and operating strategy incorporates the following elements:

- working with the Berg Group to take advantage of their abilities and resources to pursue development opportunities which we have an option to acquire, on pre-negotiated terms, upon completion and leasing;
- capitalizing on opportunistic acquisitions from third parties of high-quality R&D/office properties that provide attractive initial yields and significant potential for growth in cash-flow;
- focusing on general purpose, single-tenant Silicon Valley R&D/office properties for information technology companies in order to maintain low operating costs, reduce tenant turnover and capitalize on our relationships with these companies and our extensive knowledge of their real estate needs; and

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- maintaining prudent financial management principles that emphasize current cash flow while building long-term value, the acquisition of pre-leased properties to reduce development and leasing risks and the maintenance of sufficient liquidity to acquire and finance properties on desirable terms.

CURRENT ECONOMIC ENVIRONMENT

All of our properties are located in the Northern California area known as Silicon Valley, which generally consists of portions of Santa Clara County, Southwestern Alameda County, Southeastern San Mateo County and Eastern Santa Cruz County. The Silicon Valley economy and business activity have slowed markedly since 2001 after fast-paced growth in 1999 and 2000. The Silicon Valley R&D property market has historically fluctuated with the local economy. According to a recent report by BT Commercial Real Estate, vacancy rates for Silicon Valley R&D property was approximately 22.5% in late 2003 and at the end of the third quarter 2004. Total vacant R&D square footage in Silicon Valley at the end of the third quarter of 2004 amounted to 34.8 million square feet, of which 26.7%, or 9.3 million square feet, was being offered under subleases. Total negative net absorption (which is the computation of gross square footage leased less gross new square footage vacated for the period presented) in 2003 amounted to approximately (3.0) million square feet. During the first nine months of 2004, there was total negative net absorption of approximately (0.7) million square feet. Average asking market rent per square foot have decreased from \$1.00 in late 2003 to \$0.91 at the end of the third quarter of 2004, although individual properties within any particular submarket presently may be leased above or below the current average asking market rental rates within that submarket. The impact of the rental market decline has not been uniform throughout the area, however. The Silicon Valley R&D property market has been characterized by a substantial number of submarkets, with rent and vacancy rates varying by submarket and location within each submarket.

Our physical occupancy rate at September 30, 2004 was 69%, which is a

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significant decline from the occupancy rate of 78.3% at September 30, 2003. We believe that our physical occupancy rate could decline further going forward if key tenants seek the protection of bankruptcy laws, consolidate operations or discontinue operations. In addition, leases with respect to approximately 140,000 rentable square feet are expiring prior to the end of 2004. The properties subject to these leases may take anywhere from 12 to 18 months or longer to re-lease. We believe that the average 2004 renewal rental rates for our properties will be approximately equal to, or perhaps, below current market rents, but we cannot give any assurance that leases will be renewed or that available space will be re-leased at rental rates equal to or above the current quoted market rates. If we are unable to lease a significant portion of any vacant space or space subject to expiring leases; if we experience significant tenant defaults as a result of the current economic downturn; if we are not able to lease space at or above current market rates; or if we restructure existing leases and lower existing rents in order to retain tenants for an extended term, our results of operations and cash flows will be adversely affected. Furthermore, in this event it is probable that our board of directors will reduce the quarterly dividend on the common stock and the outstanding O.P. units. Our operating results and ability to pay dividends at current levels remain subject to a number of material risks, as indicated under the caption "Forward-Looking Information" above and in the section entitled "Risk Factors" in our most recent annual report on Form 10-K.

IMPACT OF RESTATEMENTS

We have restated our previously reported quarterly information for the three and nine months ended September 30, 2003. The restated consolidated financial statements were reported and are further discussed in our 2003 Form 10-K filed on July 30, 2004. The items that we restated for are as follows:

- We recorded additional amortization expense relating to certain leasing commissions, which were originally being amortized over a 40-year period. The additional amortization expense resulted from changing the amortization period of commissions from 40 years to the term of the lease and the write-off of certain unamortized leasing commissions in connection with tenant bankruptcies.
- We corrected the purchase accounting originally applied to our 2002 acquisition of the Orchard-Trimble property. In accordance with Statement of Financial Accounting Standards (SFAS) No. 141, Business Combinations, which became effective July 1, 2001, we allocated a portion of the purchase price to in-place lease intangible assets and recorded additional amortization expense from changing the amortization period of these intangible assets from 40 years to the term of the lease.
- We recorded additional depreciation expense relating to the reclassification of certain real estate assets from a 40-year depreciable life to a 7- and 25-year depreciable life.
- We reclassified the amortization of the above-market lease intangible asset relating to the 2003 acquisition of the San Thomas Technology Park from amortization expense to an offset to rental revenue from real estate.

The aggregate net impact of all restatement items on our Consolidated Statements of Operations for the three and nine months ended September 30, 2003 resulted in a decrease in net income to common stockholders compared to previously reported amounts of \$50,000 (\$0.00 per diluted share) and \$139,000 (\$0.01 per diluted share), respectively.

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The effects of the restatement items described above on our net income to common stockholders for the three and nine months ended September 30, 2003 are as follows:

	Three Months Ended September 30, 2003	Nine Months September 30

	(dollars in thousands)	
Net income to common stockholders, as previously reported	\$3,943	\$12,132
Impact of adjustments for:		
Leasing commission amortization	(128)	(384)
Intangible asset amortization	(137)	(410)
Depreciation of real estate assets	(35)	(49)

Total adjustments	(300)	(843)

Minority interest portion of adjustments	250	704

Net income to common stockholders, as restated	\$3,893	\$11,993
	=====	

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

We prepare the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America ("GAAP"), which requires us to make certain estimates, judgments and assumptions that affect the reported amounts in the accompanying consolidated financial statements, disclosure of contingent assets and liabilities and related footnotes. Accounting and disclosure decisions with respect to material transactions that are subject to significant management judgments or estimates include impairment of long lived assets, deferred rent reserves, and allocation of purchase price relating to property acquisitions and the related depreciable lives assigned. Actual results may differ from these estimates under different assumptions or conditions.

Critical accounting policies are defined as those that require management to make estimates, judgments and assumptions, giving due consideration to materiality, in certain circumstances that affect amounts reported in the consolidated financial statements, and potentially result in materially different results under different conditions and assumptions. We believe that the following best describe our critical accounting policies:

BUSINESS COMBINATIONS. Statement of financial Accounting Standards No. 141 ("SFAS No. 141"), Business Combinations, was effective July 1, 2001. The acquisition costs of each property acquired prior to July 1, 2001 were allocated only to building, land and leasing commissions with building depreciation being computed based on an estimated weighted average composite useful life of 40 years and leasing commissions amortization being computed over the term of the lease. Acquisitions of properties made subsequent to the effective date of SFAS No. 141 are based on an allocation of the acquisition cost to land, building, tenant improvements, and intangibles for at market and above market in place leases, and the determination of their useful lives are guided by a combination of SFAS No. 141 and management's estimates. If we do not appropriately allocate these components or we incorrectly estimate the useful lives of these components, our computation of depreciation and amortization expense may not appropriately reflect the actual impact of these costs over future periods, which will affect net income.

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IMPAIRMENT OF LONG-LIVED ASSETS. We review real estate assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable in accordance with Statement of Financial Accounting Standards No. 144 ("SFAS No. 144"), Accounting for the Impairment and Disposal of Long-Lived Assets. If the carrying amount of the asset exceeds its estimated undiscounted net cash flow, before interest, we will recognize an impairment loss equal to the difference between its carrying amount and its estimated fair value. If impairment is recognized, the reduced carrying amount of the asset will be accounted for as its new cost. For a depreciable asset, the new cost will be depreciated over the asset's remaining useful life. Generally, fair values are estimated using discounted cash flow, replacement cost or market comparison analyses. The process of evaluating for impairment requires estimates as to future events and conditions, which are subject to varying market factors, such as the vacancy rates, future rental rates and operating costs for R&D facilities in the Silicon Valley area and related submarkets. Therefore, it is reasonably possible that a change in estimate resulting from judgments as to future events could occur which would affect the recorded amounts of the property. To date we have not recognized an impairment of any long-lived assets.

ALLOWANCE FOR DOUBTFUL ACCOUNTS AND DEFERRED RENT. The preparation of the consolidated financial statements requires us to make estimates and assumptions. As such, we must make estimates of the uncollectibility of our accounts receivable based on the evaluation of our tenants' financial position, analyses of accounts receivable and current economic trends. We also make estimates for reserves against our deferred rent receivable for existing tenants with the potential of early termination, bankruptcy or ceasing operations. We charge or credit rental income for increases or decreases to our deferred rent reserves. Our estimates are based on our review of tenants' payment histories, publicly available financial information and such additional information about their financial condition as tenants provide to us. The information available to us might lead us to overstate or understate these reserve amounts. The use of different estimates or assumptions could produce different results. Moreover, actual future collections of accounts receivable or reductions in future reported rental income due to tenant bankruptcies or other business failures could differ materially from our estimates.

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CONSOLIDATED JOINT VENTURES. We, through an operating partnership, own three properties that are in joint ventures of which we have controlling interests. We manage and operate all three properties. The recognition of these properties and their operating results are 100% reflected on our consolidated financial statements, with appropriate allocation to minority interest, because we have operational and financial control of the investments. We make judgments and assumptions about the estimated monthly payments made to our minority interest joint venture partners, which are reported with our periodic results of operations. Actual results may differ from these estimates under different assumptions or conditions.

INVESTMENT IN UNCONSOLIDATED JOINT VENTURE. We, through an operating partnership, have a 50% non-controlling limited partnership interest in one unconsolidated joint venture. This investment is not consolidated because we do not exercise significant control over major operating and financial decisions. We account for the joint venture using the equity method of accounting.

FAIR VALUE OF FINANCIAL INSTRUMENTS. Our financial instruments include cash and cash equivalents, accounts receivable, accounts payable, and debt. Considerable judgment is required in interpreting market data to develop estimates of fair value. Our estimates of fair value are not necessarily indicative of the amounts that we could realize in a current market exchange. The use of different market

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assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts. Cash and cash equivalents, accounts receivable, and accounts payable are carried at amounts that approximate their fair values due to their short-term maturities. The carrying amounts of our variable rate debt approximate fair value since the interest rates on these instruments are equivalent to rates currently offered to us. For fixed rate debt, we estimate fair value by using discounted cash flow analyses based on borrowing rates for similar kinds of borrowing arrangements. The fair value of our fixed rate debt at September 30, 2004 was approximately \$234 million.

REVENUE RECOGNITION. Rental revenue is recognized on the straight-line method of accounting required by GAAP under which contractual rent payment increases are recognized evenly over the lease term, regardless of when the rent payments are received by us. The difference between recognized rental income and rental cash receipts is recorded as Deferred Rent Receivable on the consolidated balance sheets.

Certain lease agreements contain terms that provide for additional rents based on reimbursement of certain costs. These additional rents are reflected on the accrual basis.

Rental revenue is affected if existing tenants terminate or amend their leases. We try to identify tenants who may be likely to declare bankruptcy or cease operations. By anticipating these events in advance, we expect to take steps to minimize their impact on our reported results of operations through lease renegotiations, reserves against deferred rent, and other appropriate measures. Our judgments and estimations about tenants' capacity to continue to meet their lease obligations will affect the rental revenue recognized. Material differences may result in the amount and timing of our rental revenue for any period if we made different judgments or estimations.

Lease termination fees are included in other income. These fees are paid by tenants who want to terminate their lease obligations before the end of the contractual term of the lease. There is no way of predicting or forecasting the timing or amounts of future lease termination fees.

We recognize income from rent, tenant reimbursements and lease termination fees and other income once all of the following criteria are met in accordance with SEC Staff Accounting Bulletin 104:

- the agreement has been fully executed and delivered;
- services have been rendered;
- the amount is fixed and determinable; and
- collectibility is reasonably assured.

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RESULTS OF OPERATIONS

COMPARISON OF THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2004 TO THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2003

As of September 30, 2004, through our controlling interests in the operating partnerships, we owned 109 properties totaling approximately 7.9 million rentable square feet compared to 108 properties totaling approximately 7.8 million rentable square feet owned by us as of September 30, 2003. This represents a net increase of approximately 1% in total rentable square footage, which is primarily attributable to our acquisition in December 2003 of one property located in San Jose, California consisting of approximately 129,000 rentable square feet from the Berg Group.

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Rental revenue from real estate for the three and nine months ended September 30, 2004 compared to the three- and nine-month periods in 2003 are as follows:

Three Months Ended September 30,				% Change by
	2004	2003	\$ Change	Property Gro
-----				-----
(dollars in thousands)				
Same Property (1)	\$26,662	\$30,537	(\$3,875)	(12.7%)
2003 Acquisitions (2)	2,918	2,773	145	5.2%
	-----	-----	-----	
	\$29,580	\$33,310	(\$3,730)	(11.2%)
	=====	=====	=====	
Nine Months Ended September 30,				% Change by
	2004	2003	\$ Change	Property Gro
-----				-----
(dollars in thousands)				
Same Property (1)	\$82,303	\$92,227	(\$9,924)	(10.8%)
2003 Acquisitions (2)	8,754	5,237	3,517	67.2%
	-----	-----	-----	
	\$91,057	\$97,464	(\$6,407)	(6.6%)
	=====	=====	=====	

- (1) "Same Property" is defined as properties owned by us prior to 2003 that we still owned as of September 30, 2004.
- (2) Operating rental revenue for 2003 Acquisitions does not reflect a full 12 months of operations in 2003 because these properties were acquired at various times during 2003. The 2003 acquisition amount for the three months ended September 30, 2004 and 2003 each includes approximately \$0.5 million of above market rent amortization against rental revenue from real estate in connection with the implementation of SFAS No. 141. The 2003 acquisition amount for the nine months ended September 30, 2004 and 2003 includes approximately \$1.4 million and \$0.9 million, respectively, of above market rent amortization against rental revenue from real estate in connection with the implementation of SFAS No. 141.

RENTAL REVENUE FROM REAL ESTATE

For the quarter ended September 30, 2004, rental revenue from real estate decreased by approximately (\$3.7) million, or 11.2%, from \$33.3 million for the three months ended September 30, 2003 to \$29.6 million for the same period of 2004. The net decrease resulted from a decline of (\$3.9) million in rental revenue from our "Same Property" portfolio and an increase of \$0.1 million from properties acquired in 2003. Rental revenue decreased by approximately (\$6.4) million, or 6.6%, from \$97.5 million for the nine months ended September 30, 2003 to \$91.1 million for the same period of 2004. Of the (\$6.4) million decrease in rental revenue, (\$9.9) million resulted from our "Same Property" portfolio, which was partially offset by \$3.5 million generated by properties acquired in 2003. The overall decline in rental revenue was a result of adverse market conditions, lower rental rate on new leases and renewals and the loss of several tenants due to their bankruptcy, relocation or cessation of operations since September 30, 2003. Our physical occupancy rate at September 30, 2004 was approximately 69%, compared to approximately 78% at September 30, 2003.

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EQUITY IN EARNINGS FROM UNCONSOLIDATED JOINT VENTURE

As of September 30, 2004, we had investments in four R&D buildings, totaling 593,000 rentable square feet, through an unconsolidated joint venture, TBI-MSW, in which we acquired a 50% interest in January 2003 from the Berg Group under the Berg Land Holdings Option Agreement. We have a non-controlling limited partnership interest in this joint venture, which we account for using the equity method of accounting. For the three months ended September 30, 2004, we recorded equity in earnings from the unconsolidated joint venture of approximately \$0.3 million compared to \$0.6 million for the same period in 2003. Our equity in earnings from this unconsolidated joint venture declined in the third quarter of 2004 due to a rent reduction under a lease with an existing tenant. For the nine-month periods ended September 30, 2004 and 2003, equity in earnings from the unconsolidated joint venture was approximately \$1.6 million and \$3.4 million, respectively. Included in equity in earnings of unconsolidated joint venture for the nine-month period ended September 30, 2003 is approximately \$1.4 million relating to a gain from the sale of real estate. Our 50% interest in this property was acquired by TBI-MSW from the Berg Group and sold to an unrelated party during the second quarter of 2003. This type of transaction did not recur in 2004.

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OTHER INCOME

Other income decreased to approximately \$0.4 million for the three months ended September 30, 2004 from \$0.6 million for the second quarter of 2003. For the nine months ended September 30, 2004 and 2003, other income was \$5.4 million and \$1.9 million, respectively. Lease termination fees of approximately \$2.6 million and tenant bankruptcy settlement income of approximately \$1.1 million represented most of the 2004 increase. We do not consider these transactions to be recurring items.

EXPENSES

Property operating expenses and real estate taxes during the third quarter of 2004 decreased by approximately (\$0.7) million, or 12.5%, from \$5.6 million to \$4.9 million for the three months ended September 30, 2003 and 2004, respectively, due to lower property tax expense associated with reductions in assessed property values on existing properties and lower occupancy rate on our properties. Tenant reimbursements decreased by approximately (\$1.0) million, or 20.8%, from \$4.8 million for the three months ended September 30, 2003 to \$3.8 million for the three months ended September 30, 2004. Property operating expenses and real estate taxes decreased by approximately (\$0.2) million, or 1.3%, from \$15.7 million to \$15.5 million for the nine months ended September 30, 2003 and 2004, respectively, due to lower property tax expense from the reductions in assessed property values on existing properties. Tenant reimbursements decreased by approximately (\$2.6) million, or 18.2%, from \$14.3 million for the nine months ended September 30, 2003 to \$11.7 million for the nine months ended September 30, 2004. The decrease in tenant reimbursements for both periods ended September 30, 2004 as compared to the same periods in 2003 was due to lower occupancy in the current period. Certain expenses such as property insurance, real estate taxes, and other fixed expenses are not recoverable from vacant properties. General and administrative expenses remained relatively the same at \$0.4 million for the three months ended September 30, 2003 and 2004. For the nine months ended September 30, 2003 and 2004, general and administrative expenses increased by approximately \$0.6 million, or 60%, from \$1.0 million to \$1.6 million, respectively. The increase in general and administrative expenses for the nine months ended September 30, 2004 was a result of incurring additional legal and accounting expenses in connection with the resignation of PricewaterhouseCoopers LLP, our former independent

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accountants and the need to re-audit consolidated financial statements for years 2001 and 2002 and audit 2003 results.

Depreciation and amortization expense of real estate decreased by approximately \$0.1 million, or 1.8%, from \$5.5 million to \$5.4 million for the three months ended September 30, 2003 and 2004, respectively, reflecting the decrease in amortization expense of in-place leases in connection with the write-off of certain remaining in-place lease intangible asset due to lease termination in the second quarter 2004. Depreciation and amortization expense of real estate increased by approximately \$1.3 million, or 8.5%, from \$15.3 million to \$16.6 million for the nine months ended September 30, 2003 and 2004, respectively, because of the depreciation on the newly acquired San Tomas Technology Park and the amortization expense of in-place leases in connection with the implementation of SFAS No. 141. The \$5.5 million and the \$15.3 million of such expense for the three and nine months ended September 30, 2003, respectively, include \$0.17 million and \$0.46 million, respectively, that resulted from the reclassification of assets and the resulting restatement described in Note 7 of Notes to Consolidated Financial Statements in Part I, Item 1, above.

Interest expense increased by approximately \$0.1 million, or 2.3%, from \$4.3 million for the three months ended September 30, 2003 to \$4.4 million for the three months ended September 30, 2004. Interest expense (related parties) remained relatively stable at approximately \$0.3 million for the current three-month period compared to the same period one year ago. Total debt outstanding, including amounts due related parties, increased by approximately \$0.7 million, or 0.2%, from \$332.7 million as of September 30, 2003 to \$333.4 million as of September 30, 2004. Overall interest expense, including amounts paid to related parties, for the quarter ended September 30, 2004 increased by approximately \$0.1 million compared to the same quarter a year ago.

Interest expense increased by approximately \$1.0 million, or 8.3%, from \$12.1 million for the nine months ended September 30, 2003 to \$13.1 million for the nine months ended September 30, 2004 primarily because the \$80 million mortgage loan from Citicorp USA, Inc. was outstanding for the full nine months in 2004. Interest expense (related parties) decreased by approximately (\$70,000), or 8.4%, from \$830,000 for the nine months ended September 30, 2003 to \$760,000 for the nine months ended September 30, 2004 due to a lower balance owed on the Berg Group line of credit. Overall interest expense, including amounts paid to related parties, for the nine months ended September 30, 2004 increased by approximately \$0.9 million compared to the nine months ended September 30, 2003 principally because the Citicorp mortgage loan was outstanding for the entire period and we substituted new debt at slightly higher rates for borrowings under the Berg Group line of credit.

NET INCOME TO COMMON STOCKHOLDERS AND NET INCOME TO MINORITY INTEREST

Minority interest in net income has been calculated by taking the net income of the operating partnerships (on a stand-alone basis) multiplied by the respective minority interest ownership percentage. Minority interest represents the ownership interest of all limited partners in the operating partnerships taken as a whole, which was approximately 83% as of September 30, 2004 and 2003.

Net income to common stockholders decreased by approximately (\$0.7) million, or 17.9%, from \$3.9 million for the three months ended September 30, 2003 to \$3.2 million for the same period in 2004. The minority interest portion of income decreased by approximately (\$3.8) million, or 19.7%, from \$19.3 million for the three months ended September 30, 2003 to \$15.5 million for the three months ended September 30, 2004. For the nine months ended September 30, 2004 and 2003, the minority interest portion of income was approximately \$51.6 million and \$60.1 million, respectively, resulting in net income to stockholders of approximately \$10.5 million and \$12.0 million, respectively. The decline in net income and minority interest portion of income was primarily due to reduced rental revenue, un-reimbursed operating expenses from vacant properties and a

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\$1.4 million gain on sale of property by the unconsolidated joint venture in 2003 that did not recur in 2004.

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CHANGES IN FINANCIAL CONDITION

At September 30, 2004, total stockholders' equity, net, decreased by approximately (\$0.3) million from December 31, 2003 as we obtained additional capital from stock option exercises and the exchange of O.P. units for shares of our common stock while incurring a deficit of approximately (\$2.5) million due to dividends declared in excess of net income for the period. During the nine months ended September 30, 2004, stock options to purchase 20,000 shares of common stock were exercised at \$8.25 per share. Total proceeds were approximately \$0.17 million. During the first nine months of 2004, two limited partners exchanged 104,500 O.P. units for 104,500 shares of our common stock and Carl E. Berg gave 58,000 O.P. units to charitable institutions that exchanged them for 58,000 shares of our common stock under the Exchange Rights Agreement among us and the limited partners in the operating partnerships. The newly issued shares increased additional paid in capital by approximately \$2.2 million.

LIQUIDITY AND CAPITAL RESOURCES

We expect our principal source of liquidity for distributions to stockholders and O.P. unit holders, debt service, leasing commissions and recurring capital expenditures to come from cash provided by operations and/or the borrowings under the lines of credit with the Berg Group and Cupertino National Bank. We expect these sources of liquidity to be adequate to meet projected distributions to stockholders and other presently anticipated liquidity requirements in 2004. We expect to meet our long-term liquidity requirements for the funding of property development, property acquisitions and other material non-recurring capital improvements through long-term secured and unsecured indebtedness and the issuance of additional equity securities by us. We have the ability to meet short-term obligations or other liquidity needs based on lines of credit with the Berg Group and Cupertino National Bank, assuming renewal of our existing \$40 million line of credit which expires in November 2004. Despite the current weakness in the economy, we expect our total interest expense to increase as interest rates rise and as we incur debt through acquisitions of new properties and financing activities. In the remainder of 2004, we will be obligated to make payments totaling approximately \$28.6 million of debt principal under mortgage notes without regard to any debt refinancing or new debt obligations that we might incur, or optional payments of debt principal.

DISTRIBUTIONS

On October 7, 2004, we paid dividends of \$0.24 per share of common stock to all common stockholders of record as of September 30, 2004. On the same date, the operating partnerships paid a distribution of \$0.24 per O.P. unit to all holders of O.P. units.

CONTRACTUAL OBLIGATIONS

The following table identifies our contractual obligations as of September 30, 2004 that will impact liquidity and cash flow in future periods:

Three Months Remaining	Year Ending December 31,				2007
	2004	2005	2006	2007	
					20

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(dollars in thousands)

Debt Obligations (1)	\$28,565	\$9,662	\$82,375	\$6,350	\$116,952
Operating Lease Obligations (2)	23	90	90	23	226
Total	\$28,588	\$9,752	\$82,465	\$6,373	\$117,178

- (1) Debt obligations are set forth in detail in the schedule below. The amount due in 2004 does not reflect the planned two-year extension of the Cupertino National Bank loan described in Liquidity and Capital Resources above and does not take into account the Prudential Capital Group loan paid off in October 2004.
- (2) Operating lease obligations relate to a lease of our corporate office facility from a related party.

At September 30, 2004, we had total indebtedness of \$333.4 million, including \$215.9 million of fixed rate mortgage debt, \$10.5 million under the Berg Group mortgage note (related parties), \$79.4 million under the Citicorp USA mortgage loan, \$26.5 million under the Cupertino National Bank line of credit, and \$1.1 million under the Berg Group line of credit (related parties), as detailed in the table below.

On October 14, 2004, we concluded the renewal and extension of our \$80 million mortgage term loan with Citicorp USA, Inc. for an additional two years until September 6, 2006 (the "Citicorp Loan"). The Citicorp Loan requires monthly principal payments of \$215 and carries a variable interest rate of LIBOR plus 2%. The loan fee and costs incurred in connection with the mortgage loan extension amounted to approximately \$0.14 million and will be amortized over the term of the loan. Under the previous loan terms Carl E. Berg had personally guaranteed our repayment obligations and provided a personal guaranty of our obligation to indemnify the lender for certain potential environmental liabilities with respect to the pledged properties. Those guaranties were provided in conjunction with Citicorp's short-term loan of \$80 million for our acquisition of the San Tomas Technology Park and were released by Citicorp as part of the loan renewal and extension. The loan is secured by seven of our properties. The Citicorp Loan terms require us to maintain a minimum excess of assets over liabilities of \$400,000, in addition to complying with other customary loan covenants and conditions.

In July 2004, the \$40 million line of credit with Cupertino National Bank was scheduled to mature. Cupertino National Bank has granted an extension of the loan to November 2, 2004. We are in the process of renegotiating the terms and extending this loan for an additional two-year period. Assuming the renewal occurs, which we anticipate, we do not believe that the terms of the extended loan will differ

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materially from its current terms. We are the borrower under the Cupertino National Bank line of credit which is guaranteed by Mission West Properties, L.P. and Mission West Properties, L.P. II. Mission West Properties, L.P. is the borrower under the Citicorp, USA, Inc. mortgage loan which is guaranteed by Mission West Properties, L.P. I, Mission West Properties L.P. II and Mission West Properties L.P. III. The Cupertino National Bank line of credit and Citicorp USA, Inc. mortgage loan contain certain loan covenants. As of September 30, 2004, we were in compliance with such loan covenants.

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The following table sets forth information regarding debt outstanding as of September 30, 2004:

Debt Description	Collateral Properties	Balance
		(dollars in
Line of Credit:		
Berg Group (related parties)	2033-2043 Samaritan Dr., San Jose, CA 2133 Samaritan Drive, San Jose, CA 2233-2243 Samaritan Dr., San Jose, CA 1310-1450 McCandless Dr., Milpitas, CA 1795-1845 McCandless Dr., Milpitas, CA	\$ 1
Cupertino National Bank	Not Applicable	26
Mortgage Notes Payable (related parties):	5300 & 5350 Hellyer Ave., San Jose, CA	10
Mortgage Notes Payable (2):		
Prudential Capital Group (6)	20400 Mariani Avenue, Cupertino, CA	
Washington Mutual (Home Savings & Loan Assoc.)	10460 Bubb Road, Cupertino, CA	
Prudential Insurance Company of America (3)	10300 Bubb Road, Cupertino, CA 10500 N. De Anza Blvd., Cupertino, CA 4050 Starboard Drive, Fremont, CA 45700 Northport Loop, Fremont, CA 45738 Northport Loop, Fremont, CA 450 National Avenue, Mountain View, CA 6311 San Ignacio Avenue, San Jose, CA 6321 San Ignacio Avenue, San Jose, CA 6325 San Ignacio Avenue, San Jose, CA 6331 San Ignacio Avenue, San Jose, CA 6341 San Ignacio Avenue, San Jose, CA 6351 San Ignacio Avenue, San Jose, CA 3236 Scott Boulevard, Santa Clara, CA 3560 Bassett Street, Santa Clara, CA 3570 Bassett Street, Santa Clara, CA 3580 Bassett Street, Santa Clara, CA 1135 Kern Avenue, Sunnyvale, CA 1212 Bordeaux Lane, Sunnyvale, CA 1230 E. Arques, Sunnyvale, CA 1250 E. Arques, Sunnyvale, CA 1170 Morse Avenue, Sunnyvale, CA 1600 Memorex Drive, Santa Clara, CA 1688 Richard Avenue, Santa Clara, CA 1700 Richard Avenue, Santa Clara, CA 3540 Bassett Street, Santa Clara, CA 3542 Bassett Street, Santa Clara, CA 3544 Bassett Street, Santa Clara, CA 3550 Bassett Street, Santa Clara, CA	119
Northwestern Mutual Life Insurance Company (5)	1750 Automation Parkway, San Jose, CA 1756 Automation Parkway, San Jose, CA 1762 Automation Parkway, San Jose, CA 6320 San Ignacio Avenue, San Jose, CA 6540-6541 Via Del Oro, San Jose, CA 6385-6387 San Ignacio Ave., San Jose, CA 2251 Lawson Lane, Santa Clara, CA	95

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1325 McCandless Drive, Milpitas, CA
 1650-1690 McCandless Drive, Milpitas, CA
 20605-20705 Valley Green Dr., Cupertino, CA

Citicorp USA, Inc.

2001 Walsh Avenue, Santa Clara, CA
 2880 Scott Boulevard, Santa Clara, CA
 2890 Scott Boulevard, Santa Clara, CA
 2770-2800 Scott Boulevard, Santa Clara, CA
 2300 Central Expressway, Santa Clara, CA
 2220 Central Expressway, Santa Clara, CA
 2330 Central Expressway, Santa Clara, CA

79

Mortgage Notes Payable Subtotal

 295

Total

 \$333
 =====

- (1) The debt owed to the Berg Group under the line of credit carries a variable interest rate equal to LIBOR plus 1.30% and is payable in full in March 2005. The interest rate at September 30, 2004 was 3.47%.
- (2) Mortgage notes payable generally require monthly installments of interest and principal over various terms extending through the year 2013. The weighted average interest rate of mortgage notes payable was 6.23% at September 30, 2004.
- (3) The Prudential Insurance loan is payable in monthly installments of \$827, which includes principal (based upon a 30-year amortization) and interest. John Kontrabecki, one of the limited partners, has guaranteed approximately \$12,000 of this debt. Costs and fees incurred with obtaining this loan aggregated approximately \$900.
- (4) Interest rate equal to LIBOR plus 2%. The interest rates for the Cupertino National Bank ("CNB") line of credit and the Citicorp USA, Inc. mortgage loan at September 30, 2004 were 3.67% and 4.25%, respectively. In September 2004, the line of credit with CNB was scheduled to mature. CNB has granted an extension until November 2, 2004 while the parties finalize the terms of the \$40,000 line of credit renewal for an additional two year-period. The Company does not believe that the terms of the extended line of credit will differ materially from its current terms. On October 14, 2004, the Citicorp Loan was extended for an additional two years until September 2006 as discussed above.
- (5) The Northwestern loan is payable in monthly installments of \$696, which includes principal (based upon a 20-year amortization) and interest. Costs and fees incurred with obtaining this loan aggregated approximately \$675.
- (6) The Prudential Capital Group mortgage note was paid off in its entirety in October 2004 and the 20400 Mariani Avenue property securing this loan was added to the properties collateralizing the Citicorp USA, Inc. mortgage loan.

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At September 30, 2004, our debt to total market capitalization ratio, which is computed as our total debt outstanding divided by the sum of total debt outstanding plus the market value of common stock (based upon the closing price of \$10.35 per share on September 30, 2004) on a fully diluted basis, including the conversion of all O.P. units into common stock, was approximately 23.6%. On September 30, 2004, the last trading day for the quarter, total market capitalization was approximately \$1.4 billion.

At September 30, 2004, the outstanding balance remaining under certain demand notes that we owed to the operating partnerships was \$1.6 million. The due date

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of the demand notes has been extended to September 30, 2005. The principal of the demand notes, along with the interest expense, which is interest income to the operating partnerships, is eliminated in consolidation and is not included in the corresponding line items within the consolidated financial statements. However, the interest income earned by the operating partnerships, which is interest expense to us, in connection with this debt, is included in the calculation of minority interest as reported on the consolidated statement of operations, thereby reducing our net income by this same amount. At present, our only means for repayment of this debt is through distributions that we receive from the operating partnerships that are in excess of the amount of dividends to be paid to our stockholders or raising additional equity capital.

HISTORICAL CASH FLOWS

COMPARISON OF THE NINE MONTHS ENDED SEPTEMBER 30, 2004 TO THE NINE MONTHS ENDED SEPTEMBER 30, 2003

Net cash provided by operating activities for the nine months ended September 30, 2004 was \$82.4 million compared to \$91.8 million for the same period in 2003. The decline resulted from the reduction in tenant expense reimbursements and decrease in rental revenue from our current portfolio of property due to tenant lease obligation defaults, tenant re-locations and lower rent renewal rates during the last quarter of 2003 and the first nine months of 2004.

Net cash used in investing activities was (\$0.4) million and (\$109.9) million for the nine months ended September 30, 2004 and 2003, respectively. Cash used in investing activities during the first nine months of 2003 related principally to the acquisition of the San Tomas Technology Park for \$110 million.

Net cash used in financing activities was (\$84.5) million for the nine months ended September 30, 2004 compared to \$18.7 million provided by financing activities for the same period in 2003. During the first nine months of 2004, we used \$9.9 million to pay outstanding debt, drew an additional \$2.5 million from the Cupertino National Bank line of credit and paid \$62.8 million for minority interest distributions and \$13.0 million for dividends to common stockholders. During the nine months ended September 30, 2003, financing activities included borrowing \$180 million under two new collateralized mortgage loans, of which \$100 million was used to repay short-term debt and the Berg Group line of credit and \$80 million was used for the acquisition of the San Tomas Technology Park as discussed above. During the same period in 2003, we used \$86.1 million of cash to repay outstanding debt, \$62.4 million for minority interest distributions and \$12.7 million for dividends to common stockholders.

FUNDS FROM OPERATIONS ("FFO")

FFO is a non-GAAP financial measurement used by real estate investment trusts to measure and compare operating performance. As defined by NAREIT, FFO represents net income (loss) before minority interest of O.P. unit holders, computed in accordance with GAAP, plus non-recurring events other than "extraordinary items" under GAAP, excluding gains and losses from sales of depreciable operating properties, plus real estate related depreciation and amortization, excluding amortization of deferred financing costs and depreciation of non-real estate assets, and after adjustments for unconsolidated partnerships and joint ventures. FFO does include impairment losses for properties held for sale and held for use. Management considers FFO an appropriate measure of performance of an equity REIT because, along with cash flows from operating activities, financing activities and investing activities, it provides investors with an understanding of our ability to incur and service debt and make capital expenditures. With the emphasis on the disclosure of operating earnings per share, we will still continue to use FFO as a measure of our performance. FFO should not be considered as an alternative for net income as a measure of profitability nor is it comparable to cash flows provided by operating

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activities determined in accordance with GAAP, nor is FFO necessarily indicative of funds available to meet our cash needs, including the need to make cash distributions to satisfy REIT requirements. For example, FFO is not adjusted for payments of debt principal required under our debt service obligations.

Our definition of FFO also assumes conversion at the beginning of the period of all convertible securities, including minority interests that might be exchanged for common stock. FFO does not represent the amount available for management's discretionary use; as such funds may be needed for capital replacement or expansion, debt service obligations or other commitments and uncertainties.

Furthermore, FFO is not comparable to similarly entitled items reported by other REITs that do not define FFO exactly as we do.

We have revised our FFO computations for 2003 for the inclusion of the amortization of leasing commissions in depreciation and amortization of real estate in order to be comparable to our 2004 FFO presentation in accordance with NAREIT guidelines and to more closely conform to the NAREIT's FFO definition. Additionally, our FFO calculation includes our portion of the depreciation and amortization of real estate from our unconsolidated joint venture.

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FFO for the three and nine months ended September 30, 2004 and 2003, as reconciled to net income to common stockholders, are summarized in the following tables:

	Three Months Ended September 30,		
	2004	2003 (As Restated)	
	(dollars in thousands)		
Net income to common stockholders (1)	\$ 3,173	\$ 3,893	\$10
Add:			
Minority interests (2)	15,377	19,225	51
Depreciation & amortization of real estate (3)	5,969	5,992	18
Less:			
Gain on sale of unconsolidated joint venture asset	-	-	
FFO (4)	\$24,519	\$29,110	\$80

(1) As restated for the three and nine months ended September 30, 2003 described in Note 7 of Notes to Consolidated Financial Statements under Part I, Item 1 above.

(2) Excludes minority interest for third parties.

(3) Includes depreciation and amortization of real estate from our unconsolidated joint venture and amortization of leasing commissions.

(4) As restated for the three and nine months ended September 30, 2003. As originally reported for that quarter, FFO was \$29,214. As originally reported for the nine months ended September 30, 2003, FFO was \$86,821.

DISTRIBUTION POLICY

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Our board of directors will determine the amount and timing of distributions to our stockholders. The board of directors will consider many factors prior to making any distributions, including the following:

- the amount of cash available for distribution;
- our financial condition;
- whether to reinvest funds rather than to distribute such funds;
- our committed and projected capital expenditures;
- the amount of cash required for new property acquisitions, including acquisitions under existing agreements with the Berg Group;
- prospects of tenant renewals and re-leases of properties subject to expiring leases;
- cash required for re-leasing activities; o the annual distribution requirements under the REIT provisions of the federal income tax laws; and
- such other factors as the board of directors deems relevant.

We cannot assure you that we will be able to meet or maintain our cash distribution objectives.

IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS

We do not believe recently issued accounting standards will materially impact our financial position, results of operations, or cash flows.

In December 2003, the FASB issued FIN 46R, "Consolidation of Variable Interest Entities," a revision to FIN 46, which was issued in January 2003. Under FIN 46R, a variable interest entity must be consolidated by a company if that company is subject to a majority of the entity's expected losses or entitled to receive a majority of the entity's expected residual returns or both. FIN 46R requires disclosures about variable interest entities that a company is not required to consolidate, but in which it has a significant variable interest. The consolidation requirements apply to existing entities in the first reporting period that ends after March 15, 2004. We adopted the consolidation requirements of FIN 46R in the first quarter of 2004. There was no significant effect on the consolidated financial position, results of operations or cash flows as a result of the initial adoption of this standard in regard to existing variable interest entities; however, newly formed entities could meet these requirements and will be recorded as appropriate.

In May 2003, the FASB issued SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity. This Statement establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). SFAS No. 150 was effective beginning in the third quarter of 2003. The FASB deferred the implementation of SFAS No. 150 as applied to certain minority interests in finite life entities, however. We adopted the requirements of SFAS No. 150 in the third quarter of 2003, and considering the aforementioned deferral, it did not impact our financial position, results of operations or cash flows.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We do not generally hold market risk sensitive instruments for trading purposes. We use fixed and variable rate debt to finance our operations. Our exposure to market risk for changes in interest rates relates primarily to our current and

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future debt obligations. We are vulnerable to significant fluctuations of interest rates on our floating rate debt and pricing on our future debt. We manage our market risk by monitoring interest rates where we try to recognize the unpredictability of the financial markets and seek to reduce potentially adverse effect on the results of our operations. This takes frequent evaluation of available lending rates and examination of opportunities to reduce interest expense through new sources of debt financing. Several factors affecting the interest rate risk include governmental monetary and tax policies, domestic and international economics and other factors that are beyond our control. The following table provides information about the principal cash flows, weighted average interest rates, and expected maturity dates for debt outstanding as of September 30, 2004. The current terms of this debt are described in Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources."

For variable rate debt, the table presents the assumption that the outstanding principal balance at September 30, 2004 will be paid upon maturity.

For fixed rate debt, the table presents the assumption that the outstanding principal balance at September 30, 2004 will be paid according to scheduled principal payments and that we will not prepay any of the outstanding principal balance.

	Three Months Remaining	Year Ending December 31,			
	2004	2005	2006	2007	2008

(dollars in thousands)					
Variable Rate Debt:					
Secured and unsecured debt	\$27,137	\$3,685	\$76,130	-	-
Weighted average interest rate	3.69%	4.19%	4.25%		
Fixed Rate Debt:					
Secured notes payable	\$1,428	\$5,977	\$6,245	\$6,350	\$116,674
Weighted average interest rate	6.23%	6.23%	6.23%	6.23%	6.23%

The primary market risks we face are interest rate fluctuations. Principal amounts outstanding under the Berg Group line of credit, the Cupertino National Bank line of credit and the Citicorp USA, Inc. mortgage loan, which are tied to a LIBOR based interest rate, were approximately \$1.1 million, \$26.5 million, and \$79.4 million, or 0.3%, 7.9% and 23.8%, respectively, of the total \$333.4 million of outstanding debt as of September 30, 2004. As a result, we pay lower rates of interest in periods of decreasing interest rates and higher rates of interest in periods of increasing interest rates. All of our debt is denominated in United States dollars. We had no interest rate caps or interest rate swap contracts at September 30, 2004.

The following discussion of market risk is based solely on a possible hypothetical change in future market conditions related to our variable-rate debt. It includes "forward-looking statements," as previously defined, regarding market risk, but we are not forecasting the occurrence of these market changes.

Based on the amount of variable debt outstanding as of September 30, 2004, a 1% increase or decrease in interest rates on our \$107.0 million of floating rate debt would decrease or increase, respectively, nine months earnings and cash flows by approximately \$0.8 million, as a result of the increased or decreased

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interest expense associated with the change in rate, and would not have an impact on the fair value of the floating rate debt. This amount is determined by considering the impact of hypothetical interest rates on our borrowing cost. Due to the uncertainty of fluctuations in interest rates and the specific actions that might be taken by us to mitigate of such fluctuations and their possible effects, the foregoing sensitivity analysis assumes no changes to our financial structure.

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ITEM 4. CONTROLS AND PROCEDURES

We strive to maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives and management necessarily is required to apply its judgment in evaluating the cost-benefit relationship of possible controls.

Until their resignation on January 26, 2004, our independent registered accounting firm was PricewaterhouseCoopers LLP. In May 2004, we hired new independent accountants, BDO Seidman, LLP who conducted audits of our financial statements for 2001, 2002 and 2003. In connection with the issuance of its report of independent registered public accounting firm, BDO Seidman, LLP reported to our audit committee a "material weakness" under standards established by the Public Company Accounting Oversight Board regarding some elements of our system of internal controls. They noted a material weakness with respect to our review and oversight of our application of purchase accounting relating to the amortization of leasing commissions on acquired buildings, as a result of which we amortized such commissions over the 40-year term of the acquired building rather than the lease term. In addition, due to our total head count of four, they have also identified certain segregation of duties issues without compensating controls.

In the view of BDO Seidman, LLP this material weakness led to certain accounting adjustments for 2003, principally pertaining to purchase accounting errors related to leasing commissions and to a much smaller extent, to correct depreciable lives for tenant improvements and base interior improvements. The error in accounting for lease commissions necessitated a significant portion of the restatements described elsewhere in this report and resulted in adjustments to our 2003 financial statements upon audit. We have conducted a review of the errors requiring restatement, including a separate review by our audit committee to determine what remedial measures were necessary. We believe our management has taken or is in the process of taking the steps necessary to correct the errors and avoid similar errors in the future. One important measure is to have our President also become involved in the review of our internal controls and procedures.

As required by SEC Rule 13a-15(b) we conducted an evaluation as of the end of the third quarter of 2004, under the supervision and with the participation of our management, including our Chief Executive Officer, President and Vice President of Finance, of the effectiveness of the design and operation of our disclosure controls and procedures. Based upon that evaluation, the Chief

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Executive Officer, President and Vice President of Finance concluded that our disclosure controls and procedures are effective in timely alerting them to material information relating to us (including our subsidiaries) required to be included in our periodic SEC filings.

While we have taken or are in the process of taking the foregoing steps in order to address the adequacy of our disclosure controls and procedures, and, in addition, to develop and implement a formal set of internal controls and procedures for financial reporting in accordance with the SEC's rules to adopt the internal control report requirements included in Section 404 of the Sarbanes-Oxley Act of 2002, the efficacy of the steps we have taken to date and the steps we are still in the process of completing is subject to continued management review supported by confirmation and testing by our internal and external auditors. As a result, it is likely that additional changes will be made to our internal controls and procedures.

CHANGES IN INTERNAL CONTROLS

Other than the foregoing initiatives, there were no significant changes in our internal controls or to our knowledge, in other factors that could significantly affect such internal controls subsequent to the date of the above-described evaluation of disclosure controls and procedures.

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PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Legal proceedings are incorporated herein by reference from Part 1 "Item 1. - Financial Statements - Note 6 - Commitments and Contingencies."

ITEM 6. EXHIBITS AND REPORTS ON FROM 8-K

a. EXHIBITS

10.29.1	Cupertino National Bank Revolving Credit Loan Agreement Change in Term
10.45.4	Citicorp USA, Inc. \$80,000,000 Fourth Amendment to Promissory Note
31.1	Section 1350 Certificate of CEO
31.2	Section 1350 Certificate of President & COO
31.3	Section 1350 Certificate of Principal Financial Officer
32	Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

b. REPORTS ON FORM 8-K

None

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the

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registrant has duly caused this report to be signed on its behalf by the undersigned thereto duly authorized.

Mission West Properties, Inc.
(Registrant)

Date: October 29, 2004

By: /s/ Carl E. Berg

Carl E. Berg
Chief Executive Officer

Date: October 29, 2004

By: /s/ Wayne N. Pham

Wayne N. Pham
Vice President of Finance and Controller
(Principal Accounting Officer and Duly
Authorized Officer)

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EXHIBIT 10.29.1

CHANGE IN TERMS AGREEMENT

Principal	Loan Date	Maturity	Loan No	Call / Coll	Account
\$40,000,000.00	08-27-2004	11-02-2004	301099227		
References in the shaded area are for Lender's use only and do not limit the applicability any particular loan or item. Any item above containing "***" has been omitted due to text l					
Borrower: Mission West Properties, Inc., A Maryland corporation 10050 Bandlely Drive Cupertino, CA 95014-2244				Lender: Cupertino National Main Office 20230 Stevens Creek Cupertino, CA 950	

LOAN TYPE. This is a Variable Rate Nondisclosable Revolving Line of Credit Loan to a Corporation for \$40,000,000.00 due on November 2, 2004. The reference rate (Three Month Libor Rate, as published on the first business day of each month, currently 1.700%) is added to the margin of 2.000%, resulting in an initial rate of 3.700. This is an unsecured renewal loan.

PRIMARY PURPOSE OF LOAN. The primary purpose of this loan is for (please initial):

_____ Personal, Family, or Household Purposes or Personal Investment.
 X CEB RM _____ Business (Including Real Estate Investment).

SPECIFIC PURPOSE. The specific purpose of this loan is: Extend maturity date of revolving line of credit.

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DISBURSEMENT INSTRUCTIONS. Borrower understands that no loan proceeds will be disbursed until all of Lender's conditions for making the loan have been satisfied. Please disburse the loan proceeds of \$40,000,000.00 as follows:

UNDISBURSED FUNDS:	\$10,137,437.70
AMOUNT PAID ON BORROWER'S ACCOUNT:	\$29,862,562.30
\$29,862,562.30 Payment on Loan # 301099227 (Disbursed)	
NOTE PRINCIPAL:	<u>\$40,000,000.00</u>

CHARGES PAID IN CASH. Borrower has paid or will pay in cash as agreed the following charges:

PREPAID FINANCE CHARGES PAID IN CASH:	\$1,000.00
\$1,000.00 Loan Fee	

TOTAL CHARGES PAID IN CASH:	\$1,000.00

FINANCIAL CONDITION. BY SIGNING THIS AUTHORIZATION, BORROWER REPRESENTS AND WARRANTS TO LENDER THAT THE INFORMATION PROVIDED ABOVE IS TRUE AND CORRECT AND THAT THERE HAS BEEN NO MATERIAL ADVERSE CHANGE IN BORROWER'S FINANCIAL CONDITION AS DISCLOSED IN BORROWER'S MOST RECENT FINANCIAL STATEMENT TO LENDER. THIS AUTHORIZATION IS DATED AUGUST 27, 2004.

BORROWER:

MISSION WEST PROPERTIES, INC., A MARYLAND CORPORATION

By: /s/ Carl E. Berg

 Carl E. Berg, Chairman & CEO
 of Mission West Properties, Inc.
 A Maryland corporation

By: /s/ Raymond V. Marino

 Raymond V. Marino, President & COO
 of Mission West Properties, Inc.
 A Maryland corporation

EXHIBIT 10.45.4

FOURTH AMENDMENT TO PROMISSORY NOTE

THIS FOURTH AMENDMENT TO PROMISSORY NOTE (the "Amendment"), is made as of August 31, 2004 by and between MISSION WEST PROPERTIES, L.P., a Delaware limited partnership ("Borrower"), and CITICORP USA, INC., a Delaware corporation ("Lender") as follows:

RECITALS

A. In connection with a loan (the "Loan"), made by Lender to Borrower, Borrower executed that certain Promissory Note, dated as of April 8, 2003, payable to Lender, in the amount of \$80,000,000, as amended by that certain First Amendment to Promissory Note dated as of June 30, 2003, by that certain Second Amendment to Promissory Note dated as of March 29, 2004, and by that certain Third Amendment to Promissory Note dated as of June 11, 2004 (as amended, the "Note"). Borrower's obligations under the Note are secured, among other security, by that certain Deed of Trust, Assignment of Leases and Rents, Security Agreement and Fixture Filing (the "Deed of Trust"), dated as of April 8, 2003 executed by Borrower, as trustor, in favor of Lender, as Beneficiary, and recorded in the official records of Santa Clara County, California on April 8, 2003 as document number 16947181, and guaranteed by that certain Guaranty (the "Guaranty"), dated as of April 8, 2003 executed by Carl E. Berg, an

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individual ("Berg"), Mission West Properties, L.P. I, a Delaware limited partnership ("MW I"), Mission West Properties, L.P. II, a Delaware limited partnership ("MW II"), and Mission West Properties, L.P. III, a Delaware limited partnership ("MW III"). Borrower, Berg, MW I, MW II and MW III have also executed and delivered to Lender that certain Environmental Indemnity Agreement (the "Environmental Indemnity") dated April 8, 2003. The Note, the Deed of Trust, the Guaranty, the Environmental Indemnity and the other documents, instruments and agreements evidencing or securing the Loan are hereinafter referred to collectively as the "Loan Documents".

B. Borrower has requested and Lender has agreed, subject to the terms of this Amendment, to modify the terms of the Note to extend the Maturity Date (as defined in the Note). NOW, THEREFORE, in consideration of the foregoing and for other good valuable consideration, the receipt and sufficiency of which are hereby acknowledged, Lender and Borrower hereby agree as follows:

AGREEMENT

1. DEFINITIONS. Except as modified herein, terms defined in the Note shall have the same meaning when used in this Amendment.

2. MODIFICATIONS TO NOTE.

(a) On and after the date of this Amendment, the definition of "Maturity Date" set forth in Paragraph 1(a) of the Note shall be amended and modified to mean September 6, 2006.

(b) Effective as of June 1, 2004 and continuing on the first (1st) day of each month thereafter, in addition to payments of accrued and unpaid interest then due on the Note, Borrower shall make principal payments in respect of the Note in the amount of \$215,000.00. The entire unpaid principal balance of the Note, together with all accrued and unpaid interest thereon, and all other amounts then due and payable under the Note and the other Loan Documents shall be due and payable on the Maturity Date of September 6, 2006.

3. REAFFIRMATION OF NOTE AND OTHER LOAN DOCUMENTS. Except as modified pursuant to Section 2 hereof, the Note is unmodified and remains in full force and effect.

4. Conditions Precedent. Before this Amendment becomes effective, the following conditions shall be satisfied at Borrower's sole cost and expense and in a manner satisfactory to Lender in the exercise of its reasonable judgment: (a) no Event of Default shall have occurred and be continuing and no other event shall have occurred and be continuing if the event, with notice or the passage of time or both, would be such an Event of Default; (b) if requested by Lender, Borrower shall have provided such title endorsements as Lender may request to insure the continuing first-lien priority of the Deed of Trust; (c) no material adverse change shall have occurred, or be reasonably likely to occur, in the Collateral or in Borrower's or any Guarantor's business conditions (financial or otherwise), operations, properties or prospects, or ability to repay the Loan; (d) MW I, MW II and MW III shall have executed the reaffirmation of its obligations attached hereto; (e) Borrower shall have paid an extension fee to Lender in an amount equal to \$100,000.00; (f) receipt by Lender of an executed and, where appropriate, acknowledged copies of a Deed of Trust, Assignment of Leases and Rents, Security Agreement and Fixture Filing (the MW I Deed of Trust), executed by MW I and an Environmental Indemnity Agreement executed by MW I, MW II, MW III and Mission West Properties, Inc., a Maryland corporation ("MW Inc."), and a First Amendment to Guaranty and Environmental Indemnity Agreement executed by Berg, MW I, MW II, MW III and MW Inc.; (g)

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receipt and review by Lender of all Leases (as defined in the Deed of Trust), together with all financial statements of any tenant under such Leases as Borrower shall have obtained in the course of its due diligence; (h) receipt and review by Lender of a property condition report of the Land, the Real Estate and the Improvements (as such terms are defined in the Deed of Trust); (i) receipt and review by Lender of a phase I environmental site assessment with respect to the Land, the Real Estate and the Improvements; (j) receipt and review by Lender of an ALTA lender's policy of title insurance with respect to the MW I Deed of Trust; and (k) receipt and review by Lender of an opinion of counsel to Borrower and Guarantor opining that the Guaranty as amended by the First Amendment to Guaranty and Environmental Indemnity Agreement has been duly authorized by all necessary corporate and partnership action, as the case may be Lender's claim on the assets of Guarantor is superior to the claim on the assets of Guarantor of any partner or any holder of any operating unit of any Guarantor.

5. BORROWER'S REPRESENTATIONS AND WARRANTIES. Borrower hereby reaffirms all of the representations and warranties set forth in the Loan Documents and further represents and warrants that: (a) the recitals set forth above in the Recitals are true, accurate and correct; (b) Borrower is the sole legal and beneficial owner of the Collateral; (c) the Deed of Trust constitutes a valid, first priority lien encumbering the Collateral and there are no other mortgages, deeds of trust or other such liens encumbering the Collateral or any portion thereof; (d) this Amendment constitutes the legal, valid and binding obligation of Borrower enforceable in accordance with its terms; (e) the execution, delivery and performance of this Amendment are within Borrower's power and authority and have been duly authorized by all requisite partnership action, and are not in contravention of any law, or of Borrower's certificate of limited partnership or partnership agreement; (f) there exists no Event of Default under the Note or any other Loan Document; and (g) there are no offsets, claims, counterclaims, cross-claims or defenses with respect to the Loan.

6. GOVERNING LAW; SEVERABILITY. This Amendment shall be governed by and construed under the internal laws (as opposed to the laws of conflicts) of the State of California. In the event that any provision or clause of this Amendment is construed by a court of competent jurisdiction to be void, invalid or unenforceable, such construction shall not affect other provisions of this Amendment which can be given effect without the void, invalid or unenforceable provision, and to this end the provisions of this Amendment are declared to be severable.

7. CAPTIONS. Titles and headings appearing in this Amendment are intended solely for means of reference and are not intended to modify any of the provisions of this Amendment.

8. ENTIRE AGREEMENT. This Amendment constitutes the entire agreement between Borrower and Lender with respect to the subject matter of this Amendment and may not be modified or amended in any manner except in writing executed and delivered by Borrower and Lender.

9. COUNTERPARTS. This Amendment may be executed in multiple counterparts, each of which, taken together, shall constitute one and the same agreement.

IN WITNESS WHEREOF, this Amendment has been duly executed as of the date set forth above.

BORROWER:

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MISSION WEST PROPERTIES, L.P.,
a Delaware limited partnership

By: Mission West Properties, Inc.,
a Maryland corporation
its general partner

By: /s/ Carl E. Berg

Carl E. Berg
Chief Executive Officer

LENDER:

CITICORP USA, INC.,
a Delaware corporation

By: /s/ David Taylor

David Taylor
Vice President

REAFFIRMATION OF GUARANTORS

Guarantor hereby (a) represents and warrants to Lender that, if Guarantor is a partnership, the execution, delivery, and performance of this Reaffirmation are within its partnership powers and have been duly authorized by all necessary partnership action; (b) represents and warrants to Lender that the execution, delivery, and performance of this Reaffirmation shall not constitute a breach of any other document, instrument or agreement to which it is a party or by which its property is bound; (c) consents to the amendment of the Loan Documents pursuant to and on the terms stated in the Amendment, including but not limited to the extension of the Maturity Date to September 6, 2006; (d) acknowledges and reaffirms its obligations owing to Lender under the Guaranty, the Environmental Indemnity and any other Loan Documents to which it is a party; and (e) ratifies, affirms, reaffirms, acknowledges, confirms agrees that each of the Guaranty, the Environmental Indemnity and any other Loan Documents to which it is a party is and shall remain in full force and effect and represents a valid and enforceable obligation of the Guarantor; provided, however, with respect solely to the obligations of Carl E. Berg, an individual ("Berg"), the Guaranty and the Environmental Indemnity shall be null, void and of no further force and effect with respect to events or circumstances first occurring after the date that the conditions precedent to the effectiveness of the Fourth Amendment to Promissory Note shall have been satisfied.

GUARANTOR:

MISSION WEST PROPERTIES, L.P. I,
a Delaware limited partnership

By: Mission West Properties, Inc.,

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a Maryland corporation
its general partner

By: /s/ Carl E. Berg

Carl E. Berg
Chief Executive Officer

MISSION WEST PROPERTIES, L.P. II,
a Delaware limited partnership

By: Mission West Properties, Inc.,
a Maryland corporation
its general partner

By: /s/ Carl E. Berg

Carl E. Berg
Chief Executive Officer

MISSION WEST PROPERTIES, L.P. III,
a Delaware limited partnership

By: Mission West Properties, Inc.,
a Maryland corporation
its general partner

By: /s/ Carl E. Berg

Carl E. Berg
Chief Executive Officer

RELEASED GUARANTOR:

/s/ Carl E. Berg

CARL E. BERG, an individual

EXHIBIT 31.1

CERTIFICATE PURSUANT TO
RULE 13a-14 THE SECURITIES EXCHANGE ACT OF 1934

I, Carl E. Berg, certify that:

1. I have reviewed this Form 10-Q of Mission West Properties, Inc. for the quarterly period ended September 30, 2004;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

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3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the period ended September 30, 2004 that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Carl E. Berg
Chairman and CEO

October 29, 2004

Exhibit 31.2

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CERTIFICATE PURSUANT TO
RULE 13a-14 THE SECURITIES EXCHANGE ACT OF 1934

I, Raymond V. Marino, certify that:

1. I have reviewed this Form 10-Q of Mission West Properties, Inc. for the quarterly period ended September 30, 2004;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the period ended September 30, 2004 that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

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Raymond V. Marino
President and Chief Operating Officer

October 29, 2004

Exhibit 31.3

CERTIFICATE PURSUANT TO
RULE 13a-14 THE SECURITIES EXCHANGE ACT OF 1934

I, Wayne N. Pham, certify that:

1. I have reviewed this Form 10-Q of Mission West Properties, Inc. for the quarterly period ended September 30, 2004;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the period ended September 30, 2004 that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the

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registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Wayne N. Pham
Vice President of Finance and Controller

October 29, 2004

Exhibit 32

CERTIFICATION OF CEO AND CFO PURSUANT TO
18 U.S.C. ss. 1350,
AS ADOPTED PURSUANT TO
ss. 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report on Form 10-Q of Mission West Properties, Inc. (the "Company") for the quarterly period ended September 30, 2004 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), each of Carl E. Berg, Chairman of the Board and Chief Executive Officer of the Company, and Wayne N. Pham, Vice President of Finance and Controller of the Company, hereby certify, pursuant to 18 U.S.C. ss. 1350, as adopted pursuant to ss. 906 of the Sarbanes-Oxley Act of 2002, to the best of his knowledge, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

Carl E. Berg
Chairman of the Board and Chief Executive Officer
October 29, 2004

Wayne N. Pham
Vice President of Finance and Controller
October 29, 2004

This certification accompanies this Report pursuant to ss. 906 of the

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Sarbanes-Oxley Act of 2002 and shall not, except to the extent required by the Sarbanes-Oxley Act of 2002, or otherwise required, be deemed filed by the Company for purposes of ss. 18 of the Securities Exchange Act of 1934, as amended.