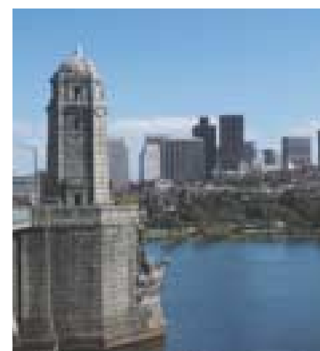
Strong Foundation, Bright Future:

An Interview with Edward H. Linde, President and Chief Executive Officer of Boston Properties, Inc.



Boston Properties, Inc., a self-administered and self-managed real estate investment trust (REIT), is one of the largest owners, managers and developers of first-class office properties in the U.S., with a significant presence in four core markets: Boston, Washington, D.C., Midtown Manhattan (New York City), and San Francisco.

Boston Properties was founded in 1970 in Boston, where it maintains its headquarters. Under the leadership of Mortimer B. Zuckerman, Chairman of the Board, and Edward H. Linde, President and Chief Executive Officer, the company acquires, develops and manages its properties through full-service regional offices in Boston, New York City, Washington, D.C., Princeton, New Jersey, and San Francisco. Boston Properties became a public company in June 1997 and its common stock is traded on the New York Stock Exchange under the symbol BXP.

The company's property portfolio primarily comprises first class office space, including high-profile buildings such as Embarcadero Center, in San Francisco; Prudential Center, in Boston; and Times Square Tower, in New York City, among others. Earlier this year, Boston Properties completed the acquisition of yet another "flagship" property — the well-known Citigroup Center in New York City.

Recently, PricewaterhouseCoopers' Global Real Estate Leader, Nick Cammarano, and real estate tax partner Timothy Egan, based in Boston, sat down with Edward Linde to get his perspective on the current state of the real estate industry as well as his company's record of success.

PwC: *Generally speaking, how would you describe Boston Properties' basic philosophy from the perspective of geographic interests, property types, and other related factors?*

BP: One of the things that I think best characterizes Boston Properties is the word "focus," because we have always felt that we could do a better job if our focus was narrow, rather than wide. And that applies to type of real estate, to geographic location, quality level, and so on. We are predominantly a developer, owner and operator of high quality office buildings. We have concentrated our activities in four major markets — Boston, where we started; Washington, D.C., where we went next; New York; and then, finally, San Francisco. We also have a satellite office in Princeton, N.J., because we do have some properties down there. But with the exception of those geographic areas, we have not spread ourselves across the country on the theory that it makes sense to be, as my colleague Mort Zuckerman is fond of saying: "An inch wide and a mile deep, rather than a mile wide and an inch deep."

Finally, in terms of being focused and being specialists in certain things, we have always operated at the high end of the quality spectrum. That's not to imply that people can't be successful operating at other places along that spectrum —

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PwC: *Would that be the reason that when you go into a market such as New York or San Francisco, you go to the Embarcadero Center, or look at Citigroup Center — do you always go for those trophy-type of properties?*

BP: I would be less than candid if I said that we weren't attracted to "name" properties — not because of the name, but because of what that means. When you acquire an Embarcadero Center in San Francisco, you are acquiring what is an acknowledged leader in that type of property in that city. And as a consequence, if you can acquire the property, you gain a tremendous marketing advantage and a tremendous financial advantage. But that doesn't hold true in all cases. For example, we looked seriously at Rockefeller Center which has that same cachet. I'm sure anybody would say it's a trophy, but the numbers didn't make sense to us. Even physically, it was a property that was not consistent with what we were doing in other places.

PwC: *You mean from the standpoint of the retail exposure?*

BP: Well, yes, retail, was one aspect — but also the buildings themselves. The buildings are definitely great assets. But they are not the kind of building you would build today, for example. So while that property will always retain its value, as we looked at the upside, we just didn't see the same kind of an upside that we saw in Embarcadero Center, where we had very contemporary kinds of buildings that had been upgraded significantly and had the potential for a re-leasing that we knew would command high rents.

PwC: *Is it your intention for the foreseeable future to stay in those markets that you're currently in? Or are you looking at any other markets right now?*

BP: At the moment, we are not looking at any other markets. That doesn't mean that we will not look at other markets and if the right opportunity came along, that we would not seize that opportunity. But we are very comfortable with where we are today, with the quality of those markets, and also with the number of other opportunities we see today right within those markets. So we really are opportunity driven and I guess if we felt we couldn't grow this company and continue to thrive in the places where we are currently doing business, then we would start looking elsewhere. But given the dynamics of a New York or San Francisco or Washington or Boston, we don't have that fear at all.

PwC: *So there really aren't any other markets that you are even considering right now?*

BP: Not at the moment. At the moment we are not considering any other geographic expansion.

PwC: *So, obviously, you also have no interest in doing any kind of international investing, correct? And I'm asking this because some of your competitors are doing it. Some of the larger opportunity funds are doing it, and some of their investors are requiring them to do it.*

BP: I can understand why the opportunity funds would go there because they have a very different perspective. They have a shorter term focus and they are more financial investors than they are operators of real estate. Our business is not only to make a good financial investment, but to enhance that financial investment through the way we operate — and also, where we have the opportunity to do development, we'll do development.

I've always been concerned, not only as a public company but also as a private company, about our ability to manage real estate and the development process in geographic loca-

tions where we might not even speak the language, let alone know all the intricacies of those markets. I think real estate is still a very local business, and if you don't have a very intuitive feel about it, or can't get good people in place that have that intuitive feel about where you're operating, I think you can do yourself damage.

PwC: *And that gets into the subject of finding the right joint venture partner, or a builder or developer over there that you can trust, which is the challenge a lot of these opportunity funds are running into.*

BP: Well, opportunity funds are set up to do joint ventures with developers much more easily than we are. We're not interested, frankly, in putting our fate into the hands of another developer. We'll do joint ventures with financial partners, but to do a joint venture with a developer would require a very special set of circumstances.

PwC: *With regard to development, do you always try to have a development project going on in the portfolio, or only if you have to, or is that not a major strategic concern?*

BP: No, it's not only if we have to. Clearly we want to have development going on, because we think we get rewarded for the skills that we have as developers. We feel the kinds of returns we're able to generate through development are going to be higher than what we can generate, generally speaking, through acquisition and/or through the continued management of existing assets. But it also would be imprudent to think that we have to have a certain amount of development every year. There will be years when it makes sense to turn the spigot down and not do development. In fact, I think one of the things that attracted investors to us when we took this company public was the fact that we had turned the development switch off in the late 1980s, probably before most other people did, and we avoided a lot of problems because of that.

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So development is something we love to do because of the returns we get, but it is not something where we have an actual formula that says we have to do so much at such and such a time or rate.

PwC: *So each project has to be decided exclusively on its own terms and conditions?*

BP: Absolutely. The numbers have to work, and also the market risk has to work. We're doing a lot of development right now — we have the largest development pipeline and the largest amount of development activity underway of any company in the country, I think. But it's also over 75 percent committed. That's the balancing act. We'll do development, but what we strive to do — and recently it is by far the preponderance of what we've done — is to have significant pre-leasing commitments.

PwC: *With regards to capitalization issues, you did an equity offering not too long ago — quite frankly, you were on a short list of decent sized REITs that even tried one. Did you consider that a successful undertaking?*

BP: Yes, it was quite successful and the timing actually turned out to be quite exquisite.

PwC: *But what I'm wondering is — you did it, it made sense and it worked. Why do you think some of your competitors chose not to go to the equity markets?*

BP: I'm not sure I can say why others chose not to go into the market. But I can tell you why we were successful. And it's pretty simple — we had a very compelling story to tell about what we were going to do with the money. It was this development pipeline that really required us to replenish our equity so that we could go forward and finish it. That was two billion dollars worth of development at the time that we had underway — and with big pre-commitments. So it wasn't that difficult to convince the investor community that we were not just simply building a war chest for god-knows-what, but that, in fact, we had identified specific places where we were going to use that money and we were going to produce very handsome returns. That's why it worked for us. Now, I think if others had tried to go out without being able to identify what they were going to do with the funds raised, then I think the natural concerns about dilution would have made it difficult to accomplish the offer.

PwC: *Would you, or have you in the past, considered acquiring another REIT?*

BP: Yes, we have, and it's no secret that in regard to a couple of the acquisitions that EOP (Equity Office Properties) made, we probably had the opportunity to get involved at some point. One or two of those companies might have fit within the overall strategy I outlined at the beginning of this conversation. For example, if you look at Spieker and the way it operated, and the kind of company they were, it was very consistent with where we are. When we did our initial offering, Spieker had already been public for a couple of years — and we were very pleased to tell people that we were going to be the East Coast version of Spieker, because we had such respect for that company. Clearly that's a company that might have made sense. As it turns out, I think EOP paid a fair price for that company — I don't know whether it would have worked for us at that price. But Spieker and one or two others fall into that category. Most of the other office REITs do not. Not that they may not be good companies, but they have product that doesn't match up with our product, or they have a geographic area that doesn't match up with our focus on just a few geographic areas.

PwC: *Do you see any of those markets slowing down?*

BP: I think all markets have slowed down. There's no question about that. But I would also say this — I am not the least bit

concerned about the four markets that we have chosen to operate in, in terms of them being weak when other markets are strong. When the markets start to turn strong, I think those four markets will be stronger. And as the markets turn weak, those four will also be weak, but stronger than others. I would rather be betting on San Francisco than Smalltown, U.S.A.

PwC: *We've talked a little about Spieker and EOP. When you internally benchmark yourself against your competitors, who do you use as your benchmark companies?*

BP: Well, we have to benchmark ourselves against EOP because they're so big. They are the only office REIT that is bigger than we are and I think the investors look at us in contrast with EOP. We clearly used to benchmark ourselves against Spieker and there are others that people like to talk about us in comparison to — so therefore we are sensitive to what they are doing — Vornado is one, for sure. Many other office REITs are quite a bit smaller and more regional than we are.

PwC: *There has been quite a bit of noise out there lately about FFO (funds from operations), the applicability of it, how to calculate it, and whether REITs should be reporting it. Where do you stand on that?*

BP: Well, it's very current. We just closed our second quarter and we'll be having our earnings call next week. Right now we're talking internally about what we should be saying and how much we should stress FFO and how much we should be talking about EPS (earnings per share). We don't have a conclusion yet, I must tell you. There is a push in NAREIT among some members to strongly support EPS. As you know, there are problems built into that as well. I don't know what the right answer is. Clearly, on our call we're going to talk about both. We report EPS anyway. And FirstCall has begun to list it, because analysts are starting to make EPS estimates, although I don't know how they are going about it. So I think there is clearly a move in that direction.

PwC: *So it wouldn't surprise you if it ended up going solely to EPS?*

BP: My problem with EPS is that it is a very volatile number, especially for a real estate developer, and doesn't treat depreciation correctly. Investors would like a measure that is auditable and it would be nice if we could move to an audited number that also treated real estate more accurately.

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PwC: *With regard to the new "fair disclosure" rules that came out – was that an issue for Boston Properties? Or was that something that was just blown out of proportion?*

BP: It hasn't really been an issue for us. I think the nature of the conversations we have had with analysts has changed. We've just gotten more public. We simply won't answer a question unless everyone is on the phone. We're giving more information on a call or in a conference, or when we have a meeting we're filing presentation materials that we give people.

PwC: *What about the change in REIT rules, with the nonqualifying sub; was that an issue for you?*

BP: Not really. Very limited. It affected our hotels — it made it a little easier to work with, made it cleaner. And some of our parking arrangements had to be changed so that's a little cleaner too. But we never really believed there was this great pot of gold at the end of the rainbow to be gained because we would sell services to all of the tenants who were dying to buy their furniture from their landlord — let alone the telecommunications stuff. They don't need us to be the middle man. It's just another layer of bureaucracy, plus someone is bound to skim something off the top, plus it gives us an added risk in drawing attention away from our core responsibility. I just never believed the enormous profits that some people were forecasting could ever materialize.

PwC: *Without revealing any specifics, are you looking at any big potential opportunities right now?*

BP: Right now, the name of the game is leasing, leasing, leasing. We are trying to forward cover our rollover as aggressively as we possibly can. Tenants are sitting on their hands, so it is very difficult to make deals; you have to work harder to make the deals. This is really a time for blocking and tackling, for basics. I'm not being dramatic. It's just that there's no major, dramatic, transforming thing that we are looking at. We continue to look at development opportunities for the future — because we still believe that's the way we will differentiate ourselves in the future. So we're taking this opportunity when, in fact, there is weakness in the market to see if we can ferret out some opportunities that may prove to be real bargains going forward. But there is nothing imminent that would be big news.

PwC: *Have you seen sellers get motivated yet to dispose of some assets?*

BP: No. There is a real disconnect between the bid and the ask. First of all, real estate is in strong hands for the most part — a lot different than it was in 1992 or 1991. And you don't have the pressure on the financial institutions that inherited real estate portfolios to try to get rid of them. Loan to value ratios never got up to the level that they were at, so you don't have a lot of desperate sellers saying "Oh, my god, I'm going to be foreclosed on, I won't have anything. I'll sell it now, and get something out of it." And I also think there are sellers who believe there is intrinsic value in their properties, which means that this is an aberration and that those values are going to come back. Now whether or not they'll feel that way six months from now, who knows? But I think for the moment they do.