

Cogdell Spencer Inc.
Form 10-Q
May 10, 2007

Table of Contents

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 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 March 31, 2007

OR

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

For the transition period from _____ to _____

Commission file number 001-32649

COGDELL SPENCER INC.

(Exact name of registrant as specified in its charter)

Maryland

(State or other jurisdiction of
incorporation or organization)

20-3126457

(I.R.S. Employer
Identification No.)

4401 Barclay Downs Drive, Suite 300

Charlotte, North Carolina

(Address of principal executive offices)

28209

(Zip code)

(704) 940-2900

(Registrant's telephone number, including area code)

N/A

(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in rule 12b-2 of the Exchange Act). Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date: 11,949,274 shares of common stock, par value \$.01 per share, outstanding as of May 8, 2007.

TABLE OF CONTENTS

	Page
<u>PART I</u>	
<u>FINANCIAL INFORMATION</u>	
<u>Item 1</u>	1
<u>Item 2</u>	10
<u>Item 3</u>	18
<u>Item 4</u>	18
<u>PART II</u>	
<u>Other Information</u>	
<u>Item 1</u>	18
<u>Item 1A</u>	19
<u>Item 2</u>	19
<u>Item 3</u>	19
<u>Item 4</u>	19
<u>Item 5</u>	19
<u>Item 6</u>	20
<u>Exhibit 31.1</u>	
<u>Exhibit 31.2</u>	
<u>Exhibit 32.1</u>	

Table of Contents**PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS**

COGDELL SPENCER INC.
CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except per share amounts)
(unaudited)

	As of March 31, 2007	As of December 31, 2006
Assets		
Real estate properties:		
Land	\$ 22,768	\$ 22,768
Buildings and improvements	341,329	339,214
Less: Accumulated depreciation	(28,489)	(23,664)
Total operating real estate properties, net	335,608	338,318
Construction in progress	20,449	12,854
Total real estate properties, net	356,057	351,172
Cash and cash equivalents	4,985	1,029
Restricted cash	874	982
Investment in capital lease	6,117	6,193
Acquired above market leases, net of accumulated amortization of \$346 in 2007 and \$290 in 2006	910	966
Acquired in place lease value and deferred leasing costs, net of accumulated amortization of \$12,951 in 2007 and \$11,184 in 2006	16,411	18,205
Acquired ground leases, net of accumulated amortization of \$120 in 2007 and \$146 in 2006	3,111	3,092
Deferred financing costs, net of accumulated amortization of \$447 in 2007 and \$342 in 2006	1,122	1,018
Goodwill	5,335	5,326
Other assets	5,683	5,075
Total assets	\$ 400,605	\$ 393,058
Liabilities and stockholders equity		
Notes payable under line of credit	\$ 11,500	\$ 77,487
Mortgage loans	182,820	184,544
Accounts payable and other liabilities	14,401	9,851
Accrued dividends and distributions	5,787	4,404
Acquired below market leases, net of accumulated amortization of \$1,620 in 2007 and \$1,384 in 2006	2,855	3,096
Total liabilities	217,363	279,382
Commitments and contingencies		
Minority interests	51,307	54,001
Stockholders equity:		

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Preferred stock, \$0.01 par value; 50,000 shares authorized, none issued or outstanding		
Common Stock; \$0.01 par value; 200,000 shares authorized, 11,949 and 8,000 shares issued and outstanding in 2007 and 2006, respectively	119	80
Additional paid-in capital	165,703	87,224
Accumulated other comprehensive income (loss)	(90)	73
Accumulated deficit	(33,797)	(27,702)
Total stockholders equity	131,935	59,675
Total liabilities and stockholders equity	\$ 400,605	\$ 393,058

See notes to condensed consolidated financial statements.

Table of Contents

COGDELL SPENCER INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share amounts)

(unaudited)

	Three Months Ended March	
	2007	2006
		31,
Revenues:		
Rental	\$ 14,315	\$ 11,718
Management fee revenue	598	343
Expense reimbursements	346	174
Development fee revenue	230	86
Interest and other income	409	292
 Total revenues	 15,898	 12,613
Expenses:		
Property operating and management	5,905	4,094
General and administrative	2,251	1,995
Depreciation	4,851	4,309
Amortization	1,791	2,152
Interest	4,035	2,391
 Total expenses	 18,833	 14,941
Loss from continuing operations before equity in earnings (loss) of unconsolidated real estate partnerships, minority interest in real estate partnership, minority interests in operating partnership and discontinued operations	(2,935)	(2,328)
Equity in earnings (loss) of unconsolidated real estate partnerships	(9)	5
Minority interests in real estate partnership	(17)	(31)
Minority interests in operating partnership	1,048	831
 Loss from continuing operations	 (1,913)	 (1,523)
Discontinued operations:		
Loss from discontinued operations		(4)
Minority interests in operating partnership		2
 Total discontinued operations		 (2)
 Net loss	 \$ (1,913)	 \$ (1,525)
 Per share data basic and diluted		
Loss from continuing operations	\$ (0.23)	\$ (0.19)
Loss from discontinued operations		
 Net loss	 \$ (0.23)	 \$ (0.19)

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Weighted average common shares basic and diluted	8,334	7,973
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See notes to condensed consolidated financial statements.

2

Table of Contents

COGDELL SPENCER INC.
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY
(In thousands)
(Unaudited)

	Number of Common Shares	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income	Accumulated Deficit	Total
Balance at December 31, 2006	8,000	\$ 80	\$ 87,224	\$ 73	\$ (27,702)	\$ 59,675
Comprehensive loss:						
Net loss					(1,913)	(1,913)
Unrealized loss on interest rate swaps				(163)		(163)
Comprehensive loss						(2,076)
Issuance of common stock, net of costs	3,949	39	78,460			78,499
Amortization of restricted stock grants			19			19
Dividends to common stockholders					(4,182)	(4,182)
Balance at March 31, 2007	11,949	\$ 119	\$ 165,703	\$ (90)	\$ (33,797)	\$ 131,935

See notes to condensed consolidated financial statements.

Table of Contents

COGDELL SPENCER INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006
Operating activities:		
Net loss	\$ (1,913)	\$ (1,525)
Adjustments to reconcile net loss to cash provided by operating activities:		
Minority interests	(1,031)	(802)
Depreciation and amortization (including amounts in discontinued operations)	6,642	6,486
Amortization of acquired above market leases and acquired below market leases, net (including amounts in discontinued operations)	(180)	(201)
Straight line rent revenue	(60)	(19)
Amortization of deferred finance costs and debt premium	56	(3)
Equity-based compensation	29	28
Equity in (earnings) loss of unconsolidated real estate partnerships	9	(5)
Change in fair value of interest rate swap agreements		(309)
Changes in operating assets and liabilities:		
Other assets	94	(68)
Accounts payable and other liabilities	1,877	893
Net cash provided by operating activities	5,523	4,475
Investing activities:		
Investment in real estate properties	(8,059)	(71,689)
Proceeds from capital lease	76	51
Purchase of corporate equipment	(237)	
Distributions received from real estate partnerships		2
Decrease (increase) in restricted cash	108	(38)
Net cash used in investing activities	(8,112)	(71,674)
Financing activities:		
Repayments of mortgage notes payable	(1,675)	(4,829)
Proceeds from line of credit	11,200	68,250
Repayments to line of credit	(77,187)	(2,000)
Net proceeds from sale of common stock	78,875	
Dividends and distributions	(4,404)	
Distributions to minority interests in real estate partnership	(68)	(85)
Payment of deferred financing costs	(196)	(24)
Net cash provided by financing activities	6,545	61,312
Increase (decrease) in cash and cash equivalents	3,956	(5,887)
Balance at beginning of period	1,029	9,571
		213

Cumulative effect adjustment associated with the implementation of EITF 04-5

Balance at end of period	\$	4,985	\$	3,897
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Supplemental disclosure of cash flow information:

Cash paid for interest, net of capitalized interest	\$	3,654	\$	2,539
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Supplemental cash flow information noncash investing and financing activities:

Debt assumed with purchase of property				5,178
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Accrued dividends and distributions		5,787		4,328
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See notes to condensed consolidated financial statements.

Table of Contents

COGDELL SPENCER INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Business Description

Cogdell Spencer Inc. (the Company), incorporated in Maryland in 2005, is a fully-integrated, self-administered and self-managed real estate investment trust (REIT) that invests in specialty office buildings for the medical profession, including medical offices, ambulatory surgery and diagnostic centers, in the United States of America. As of March 31, 2007, the Company's portfolio consisted of 50 wholly-owned properties, four joint venture properties, and 58 managed medical office buildings.

2. Summary of Significant Accounting Policies

Basis of Presentation

The Company reviews its interests in entities to determine if the entity's assets, liabilities, noncontrolling interests and results of activities should be consolidated by an entity that is included in the consolidated financial statements in accordance with Financial Accounting Standards Board (FASB) Interpretation No. 46 (revised December 2003),

Consolidation of Variable Interest Entities (FIN 46R), EITF 04-5 Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights and Accounting Research Bulletin No. 51, Consolidated Financial Statements.

The accompanying condensed consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States (GAAP) and represent the assets and liabilities and operating results of the Company. The consolidated financial statements include the Company's accounts, its wholly-owned subsidiaries, as well as the Operating Partnership and its subsidiaries. The consolidated financial statements also include any partnerships for which the Company or its subsidiaries is the general partner or the managing member and the rights of the limited partners do not overcome the presumption of control by the general partner or managing member. All significant intercompany balances and transactions have been eliminated in consolidation and combination.

Interim Financial Information

The financial information for the three months ended March 31, 2007 and 2006 is unaudited, but includes all adjustments, consisting of normal recurring adjustments that, in the opinion of management, are necessary for a fair presentation of the Company's financial position, results of operations, and cash flows for such periods. Operating results for the three months ended March 31, 2007 and 2006 are not necessarily indicative of results that may be expected for any other interim period or for the full fiscal years of 2007 or 2006 or any other future period. These condensed consolidated financial statements do not include all disclosures required by GAAP for annual consolidated financial statements. The Company's audited consolidated financial statements are contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2006.

Use of Estimates in Financial Statements

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. Significant estimates and assumptions are used by management in determining the useful lives of real estate properties and the initial valuations and underlying allocations of purchase price in connection with real estate property acquisitions. Actual results may differ from those estimates.

Reclassifications

Certain 2006 amounts have been reclassified to conform to the 2007 presentation. The reclassifications did not affect previously reported stockholders' equity or net loss. These reclassifications include the reclassification of the operating results of one property to discontinued operations. For additional information, see Note 4 to the Company's audited financial statements filed in its Annual Report on Form 10-K for the year ended December 31, 2006.

Recent Accounting Pronouncements

Table of Contents

In June 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of SFAS No. 109 (FIN 48), which clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109. FIN 48 prescribes a comprehensive model for how companies should recognize, measure, present, and disclose in their financial statements uncertain tax positions taken or expected to be taken in an income tax return. For those benefits recognized, a tax position must be more-likely-than-not to be sustained based solely upon the technical merits of the position. Such tax positions shall initially and subsequently be measured as the largest amount of tax benefit that, on a cumulative basis, is greater than 50% likely of being realized upon ultimate settlement with the tax authority assuming that the taxing authority has full knowledge of the position and all relevant facts. The Company implemented FIN 48 effective January 1, 2007. The adoption of FIN 48 did not result in an adjustment to the Company's financial statements.

In September 2006, the FASB issued SFAS No. 157 Fair Value Measurements (SFAS 157). SFAS 157 defines fair value for assets and liabilities, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS 157 is effective January 1, 2008. SFAS 157 is not expected to have a material impact on the Company's results of operations or financial position.

In September 2006, the FASB issued SFAS No. 158 Employer's Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106, and 132(R) (SFAS 158). SFAS 158 requires recognition of the funded status of such plans as an asset or liability, with changes in the funded status recognized through comprehensive income in the year in which they occur. These provisions of SFAS 158 are effective December 31, 2006. Additionally, SFAS 158 requires measurement of a plan's assets and its obligations at the end of the employer's fiscal year, effective December 31, 2008. SFAS 158 has not had, and is not expected to have, a material impact on the Company's results of operations or financial position.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of FASB Statement No. 115 (SFAS 159). SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. SFAS 159 does not affect any existing accounting literature that requires certain assets and liabilities to be carried at fair value. SFAS 159 is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact of the adoption of this new standard on its financial statements.

3. Investments in Real Estate Partnerships

As of March 31, 2007, the Company had an ownership interest in four limited liability companies or limited partnerships. The following is a description of each of the entities:

McLeod Medical Partners, LLC, a South Carolina limited liability company, founded in 1982, 1.1% owned by the Company, and owns three medical office buildings;

Shannon Health/MOB Limited Partnership No. 1, a Delaware limited partnership, founded in 2001, 2.0% owned by the Company, and owns ten medical office buildings

BSB Health/MOB Limited Partnership No. 2, a Delaware limited partnership, founded in 2002, 2.0% owned by the Company, and owns nine medical office buildings; and

Rocky Mount MOB, LLC, a North Carolina limited liability company, founded in 2002, 34.5% owned by the Company, and owns one medical office building.

The Company is the general partner or managing member of these real estate partnerships and manages the properties owned by these entities. The Company, through its taxable REIT subsidiaries, receives property management fees, leasing fees, and expense reimbursements from the partnerships.

The 2.0% ownerships in the Shannon Health/MOB Limited Partnership No. 1 and BSB Health/MOB Limited Partnership No. 2 were assumed as part of the Consera acquisition in September 2006. The partnership agreements and tenant leases of the limited partners are designed to give preferential treatment to the limited partners as to operating cash flows from the partnerships. The Company, as the general partner, does not generally participate in the

operating cash flows from these

Table of Contents

entities other than to receive property management fees. The limited partners can remove the Company as the property manager and as the general partner. These are accounted for under the equity method of accounting.

Rocky Mount MOB is included in the Company's consolidated financial statements because the limited partners do not have sufficient participation rights in the partnership to overcome the presumption of control by the Company as the managing member. The limited partners do have certain protective rights such as the ability to prevent the sale of building, the dissolution of the partnership, or the incurrence of additional indebtedness.

The Company's other real estate partnerships are unconsolidated and accounted for under the equity method of accounting based on the Company's ability to exercise significant influence. The following is a summary of financial information for the limited liability companies and limited partnerships for the periods indicated. The information set forth below reflects the unaudited financial position and operations of the three entities in their entirety, not just the Company's interest in the real estate partnerships (in thousands):

	March 31, 2007	December 31, 2006
Financial position:		
Total assets	\$ 58,868	\$ 58,267
Total liabilities	52,353	51,441
Members' equity	6,515	6,826
	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006
Results of operations:		
Revenues	\$ 2,848	\$ 1,359
Operating and general and administrative expenses	1,119	675
Net income	299	143

4. Mortgages, Notes Payable and Guarantees

In February 2007, the Company refinanced the St. Francis Medical Plaza, LLC mortgage note payable. The note payable now matures on June 15, 2008 and has a variable interest rate of LIBOR + 1.55%. In connection with the refinancing, there was a \$0.8 million principal reduction payment.

In March 2007, the Company refinanced the Rocky Mount MOB, LLC mortgage notes payable. The mortgage notes payable have aggregate monthly payments of \$30,558 with remaining principal and interest due in March 2008. These mortgage notes have fixed interest rates of 6.75%.

In March 2007, the Company obtained construction financing related to the Lancaster General Health Campus MOB project. The facility provides financing up to \$11.0 million and will convert to permanent financing at the date of occupancy. The mortgage note payable will mature five or seven years, at the Company's option, from the date of occupancy and provides for principal payments based on a 25 year amortization.

5. Minority Interests

Minority interests in the Operating Partnership at March 31, 2007 and 2006 were \$51.2 million and \$59.7 million, respectively.

As of March 31, 2007, there were 16,533,606 Operating Partnership units (OP Units) outstanding, of which 11,949,274, or 72.3%, were owned by the Company and 4,584,332, or 27.7%, were owned by other partners (including certain of our directors and senior management).

6. Dividends and Distributions

On March 20, 2007, the Company declared a dividend to common stockholders of record and the Operating Partnership declared a distribution to unitholders of record, in each case as of April 5, 2007, totaling \$5.8 million or \$0.35 per share or unit, covering the period from January 1, 2007 through March 31, 2007. The dividend and distribution were paid on April 19, 2007. The dividend and distribution were equivalent to an annual rate of \$1.40 per

share or OP unit.

Table of Contents**7. Loss per Share**

The following is a summary of the elements used in calculating basic and diluted loss per share (in thousands, except per share amount):

	Three months ended March 31, 2007	Three months ended March 31, 2006
Loss from continuing operations	\$ (1,913)	\$ (1,523)
Loss from discontinued operations		(2)
Net loss	\$ (1,913)	\$ (1,525)
Per share data basic and diluted:		
Loss from continuing operations	\$ (0.23)	\$ (0.19)
Income (loss) from discontinued operations		
Net loss	\$ (0.23)	\$ (0.19)
Weighted average shares outstanding basic and diluted	8,334	7,973

The following potentially dilutive securities were outstanding, but were not included in the computation of diluted earnings per share because the effects of their inclusion would be anti-dilutive (in thousands):

	March 31, 2007	March 31, 2006
Operating Partnership units	4,584	4,365
Unvested restricted stock	19	25
	4,603	4,390

8. Related Party Transactions

The Fork Farm, a working farm owned by the Company's Chairman and the Predecessor's founder, periodically hosts events on behalf of the Company. Charges for such events of approximately \$30,000 annually are reflected in general and administrative expenses in the consolidated statement of operations. For the period January 1, 2007 through March 31, 2007, approximately \$12,000 was paid to The Fork Farm.

9. Segment Reporting

The Company defines business segments by their distinct customer base and service provided based on the financial information used by our chief operating decision maker to make resource allocation decisions and assess performance. There are two identified reportable segments: (1) property operations and (2) real estate services. Management evaluates each segment's performance based on net operating income, which is defined as income before corporate general and administrative expenses, depreciation, amortization, interest expense, loss on early extinguishment of debt, gain on sale of real estate property, loss on unconsolidated real estate joint ventures, and minority interests in Operating Partnership. Intersegment revenues and expenses are reflected at the contractually stipulated amounts and eliminated in consolidation or combination. The following table represents the segment information for the three months ended March 31, 2007 and 2006 (in thousands):

Table of Contents

	Three Months Ended	
	March 31, 2007	March 31, 2006
Property operations:		
Rental revenues	\$ 14,315	\$ 11,718
Interest and other income	194	205
Property operating expenses	(4,245)	(3,181)
Intersegment expenses	(997)	(843)
Net operating income	\$ 9,267	\$ 7,899
Total segment assets, end of period	\$ 391,812	\$ 370,556
Real estate services:		
Fee revenue	\$ 828	\$ 429
Expense reimbursements	348	174
Interest and other income	213	85
Intersegment revenues	997	843
Real estate operating expenses	(1,955)	(1,033)
Net operating income	\$ 431	\$ 498
Total segment assets, end of period	\$ 8,793	\$ 6,325
Reconciliations:		
Total segment revenues	\$ 16,895	\$ 13,454
Elimination of intersegment revenues	(997)	(843)
Total revenues	\$ 15,898	\$ 12,611
Total segment net operating income	\$ 9,698	\$ 8,397
Corporate general and administrative expenses	(1,956)	(1,873)
Depreciation and amortization expense	(6,642)	(6,461)
Interest expense	(4,035)	(2,391)
Equity in earnings (loss) of unconsolidated real estate partnerships	(9)	5
Minority interests	1,031	800
Total discontinued operations		(2)
Net loss	\$ (1,913)	\$ (1,525)
Total segment assets	\$ 400,605	\$ 376,881
Total discontinued operations		1,504
Total assets, end of period	\$ 400,605	\$ 378,385

Table of Contents

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

When used in this discussion and elsewhere in this Quarterly Report on Form 10-Q, the words believes, anticipates, projects, should, estimates, expects, and similar expressions are intended to identify forward-looking statements with the meaning of that term in Section 27A of the Securities Act of 1933, as amended, and in Section 21F of the Securities and Exchange Act of 1934, as amended. Actual results may differ materially due to uncertainties including:

the Company's business strategy;

the Company's ability to obtain future financing arrangements;

estimates relating to the Company's future distributions;

the Company's understanding of the Company's competition;

the Company's ability to renew the Company's ground leases;

changes in the reimbursement available to the Company's tenants by government or private payors;

the Company's tenants' ability to make rent payments;

defaults by tenants;

market trends; and

projected capital expenditures.

Forward-looking statements are based on estimates as of the date of this report. The Company disclaims any obligation to publicly release the results of any revisions to these forward-looking statements reflecting new estimates, events or circumstances after the date of this report.

Overview

The Company is a fully-integrated, self-administered and self-managed REIT that invests in specialty office buildings for the medical profession, including medical offices, ambulatory surgery and diagnostic centers, in the United States of America. The Company has been built around understanding and addressing the specialized real estate needs of the healthcare industry. The Company's management team has developed long-term and extensive relationships through developing and maintaining modern, customized medical office buildings and healthcare related facilities. The Company has been able to maintain occupancy above market levels and secure strategic hospital campus locations. The Company operates its business through Cogdell Spencer LP, its operating partnership subsidiary, and its subsidiaries.

The Company derives a significant portion of its revenues from rents received from tenants under existing leases in medical office buildings and other healthcare related facilities. The Company derives a lesser portion of its revenues from fees that are paid for managing and developing medical office buildings and other healthcare related facilities for third parties. The Company's management believes a strong internal property management capability is a vital component of the Company's business, both for the properties the Company owns and for those that the Company manages.

As of March 31, 2007, the Company owned and/or managed 112 medical office buildings and healthcare related facilities, serving 27 hospital systems in ten states. The Company's aggregate portfolio was comprised of:

50 wholly owned properties;

four joint venture properties; and

58 properties owned by third parties.

10

Table of Contents

At March 31, 2007, the Company's aggregate portfolio contains approximately 5.3 million net rentable square feet, consisting of approximately 2.6 million net rentable square feet from wholly-owned properties, approximately 0.2 million net rentable square feet from joint venture properties, and approximately 2.5 million net rental square feet from properties owned by third parties and managed by the Company. Approximately 79% of the net rentable square feet of the wholly-owned properties are situated on hospital campuses. As such, the Company believes that its assets occupy a premier franchise location in relation to local hospitals, providing the Company's properties with a distinct competitive advantage over alternative medical office space in an area. As of March 31, 2007, the Company's wholly-owned properties were approximately 93.0% occupied, with a weighted average remaining lease term of approximately 3.8 years.

Factors Which May Influence Future Results of Operations

Generally, the Company's revenues and expenses have remained consistent except for development fees and changes in the fair value of interest rate swap agreements reflected in interest expense. Development fees from wholly-owned and consolidated joint venture projects are eliminated in consolidation and will continue to vary to the extent there are fees from third party projects.

Related to the Company's interest rate swap agreements that do not qualify for hedge accounting, changes in fair values, which vary from period to period based on changes in market interest rates, are recorded in interest expense. Generally, increases (decreases) in market interest rates will increase (decrease) the fair value of the derivative, which will decrease (increase) current period interest expense for the change in fair value. During the fourth quarter of 2006, the Company terminated several derivative transactions and entered into new agreements with the appropriate hedge documentation in place, which reduced the variances previously experienced in interest expense. The Company will continue to have interest expense variability for variable rate mortgages that do not have interest rate swap agreements.

Critical Accounting Policies

The Company's discussion and analysis of financial condition and results of operations are based upon the Company's consolidated financial statements and the Company's Predecessor's combined financial statements, which have been prepared on the accrual basis of accounting in conformity with GAAP. All significant intercompany balances and transactions have been eliminated in consolidation and combination.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses in the reporting period. The Company's actual results may differ from these estimates. Management has provided a summary of the Company's significant accounting policies in Note 2 to the Company's consolidated financial statements included in its Annual Report on Form 10-K for the year ended December 31, 2006. Critical accounting policies are those judged to involve accounting estimates or assumptions that may be material due to the levels of subjectivity and judgment necessary to account for uncertain matters or susceptibility of such matters to change. Other companies in similar businesses may utilize different estimation policies and methodologies, which may impact the comparability of the Company's results of operations and financial condition to those companies.

Investments in Real Estate

Acquisition of real estate. The price that the Company pays to acquire a property is impacted by many factors, including the condition of the buildings and improvements, the occupancy of the building, the existence of above and below market tenant leases, the creditworthiness of the tenants, favorable or unfavorable financing, above or below market ground leases and numerous other factors. Accordingly, the Company is required to make subjective assessments to allocate the purchase price paid to acquire investments in real estate among the assets acquired and liabilities assumed based on the Company's estimate of the fair values of such assets and liabilities. This includes determining the value of the buildings and improvements, land, any ground leases, tenant improvements, in-place tenant leases, tenant relationships, the value (or negative value) of above (or below) market leases and any debt assumed from the seller or loans made by the seller to the Company. Each of these estimates requires significant judgment and some of the estimates involve complex calculations. The Company's calculation methodology is summarized in Note 2 to the Company's audited consolidated financial statements included in its Annual Report on Form 10-K for the year ended December 31, 2006. These allocation assessments have a direct impact on the

Company's results of operations because if the Company were to allocate more value to land there would be no depreciation with respect to such amount or if the Company were to allocate more value to the buildings as opposed to allocating to the value of tenant leases, this amount would be recognized as an expense over a

Table of Contents

much longer period of time, since the amounts allocated to buildings are depreciated over the estimated lives of the buildings whereas amounts allocated to tenant leases are amortized over the terms of the leases. Additionally, the amortization of value (or negative value) assigned to above (or below) market rate leases is recorded as an adjustment to rental revenue as compared to amortization of the value of in-place leases and tenant relationships, which is included in depreciation and amortization in the Company's consolidated and combined statements of operations.

Useful lives of assets. The Company is required to make subjective assessments as to the useful lives of the Company's properties for purposes of determining the amount of depreciation to record on an annual basis with respect to the Company's investments in real estate. These assessments have a direct impact on the Company's net income (loss) because if the Company were to shorten the expected useful lives of the Company's investments in real estate the Company would depreciate such investments over fewer years, resulting in more depreciation expense on an annual basis.

Asset impairment valuation. The Company reviews the carrying value of its properties when circumstances, such as adverse market conditions, indicate a potential impairment may exist. The Company bases its review on an estimate of the future cash flows (excluding interest charges) expected to result from the real estate investment's use and eventual disposition. The Company considers factors such as future operating income, trends and prospects, as well as the effects of leasing demand, competition and other factors. If the Company's evaluation indicates that it may be unable to recover the carrying value of a real estate investment, an impairment loss is recorded to the extent that the carrying value exceeds the estimated fair value of the property. These losses have a direct impact on the Company's net income because recording an impairment loss results in an immediate negative adjustment to operating results. The evaluation of anticipated cash flows is highly subjective and is based in part on assumptions regarding future occupancy, rental rates and capital requirements that could differ materially from actual results in future periods. Since cash flows on properties considered to be long-lived assets to be held and used are considered on an undiscounted basis to determine whether an asset has been impaired, the Company's strategy of holding properties over the long-term directly decreases the likelihood of recording an impairment loss. If the Company's strategy changes or market conditions otherwise dictate an earlier sale date, an impairment loss may be recognized and such loss could be material. If the Company determines that impairment has occurred, the affected assets must be reduced to their fair value. No such impairment losses have been recognized to date. The Company estimates the fair value of rental properties utilizing a discounted cash flow analysis that includes projections of future revenues, expenses and capital improvement costs, similar to the income approach that is commonly utilized by appraisers. The Company reviews the value of Goodwill using an income approach on an annual basis and when circumstances indicate a potential impairment may exist.

Revenue Recognition

Rental income related to non-cancelable operating leases is recognized using the straight line method over the terms of the tenant leases. Deferred rents included in the Company's consolidated balance sheets represent the aggregate excess of rental revenue recognized on a straight line basis over the rental revenue that would be recognized under the cash flow received, based on the terms of the leases. The Company's leases generally contain provisions under which the tenants reimburse the Company for all property operating expenses and real estate taxes incurred by the Company. Such reimbursements are recognized in the period that the expenses are incurred. Lease termination fees are recognized when the related leases are canceled and the Company has no continuing obligation to provide services to such former tenants. As discussed above, the Company recognizes amortization of the value of acquired above or below market tenant leases as a reduction of rental income in the case of above market leases or an increase to rental revenue in the case of below market leases. The Company receives fees for property management and development and consulting services from time to time from third parties which is reflected as fee revenue. Management fees are generally based on a percentage of revenues for the month as defined in the related property management agreements. Development and consulting fees are recorded on a percentage of completion method using management's best estimate of time and costs to complete projects. The Company has a long history of developing reasonable and dependable estimates related to development or consulting contracts with clear requirements and rights of the parties to the contracts. Although not frequent, occasionally revisions to estimates of costs are necessary and are reflected as a change in estimate when known. Due to the amount of control retained by the Company, most joint venture developments will be consolidated, therefore those development fees will be eliminated in consolidation. Other

income shown in the statement of operations, generally includes interest income, primarily from the amortization of unearned income on a sales-type capital lease recognized in accordance with Statement of Financial Accounting Standards No. 13, and other income incidental to the Company's operations and is recognized when earned. The Company must make subjective estimates as to when the Company's revenue is earned and the collectibility of the Company's accounts receivable related to minimum rent, deferred rent, expense reimbursements, lease termination fees and

Table of Contents

other income. The Company specifically analyzes accounts receivable and historical bad debts, tenant concentrations, tenant creditworthiness, and current economic trends when evaluating the adequacy of the allowance for bad debts. These estimates have a direct impact on the Company's net income because a higher bad debt allowance would result in lower net income, and recognizing rental revenue as earned in one period versus another would result in higher or lower net income for a particular period.

REIT Qualification Requirements

The Company is subject to a number of operational and organizational requirements to qualify and then maintain qualification as a REIT. If the Company does not qualify as a REIT, its income would become subject to U.S. federal, state and local income taxes at regular corporate rates that would be substantial and the Company cannot re-elect to qualify as a REIT for five years. The resulting adverse effects on the Company's results of operations, liquidity and amounts distributable to stockholders would be material.

Changes in Financial Condition

On March 23, 2007, the Company issued 3,949,700 common shares at a price of \$21.00 per share resulting in net proceeds to the Company of \$78.5 million. The net proceeds were used to reduce outstanding principal on the Company's unsecured Credit Facility and for working capital.

Results of Operations

The Company's loss from operations is generated primarily from operations of its properties and development and property management fee revenue. The changes in operating results from period to period reflect changes in existing property performance and changes in the number of properties due to development, acquisition, or disposition of properties.

Property Summary

The following is an activity summary of the Company's property portfolio (excluding unconsolidated real estate partnerships) for the three months ended March 31, 2007 and 2006 and the year ended December 31, 2006:

	Three Months Ended	
	March 31, 2007	March 31, 2006
Properties at January 1	50	44
Consolidation of Rocky Mount MOB LLC		1
Acquisitions		4
Dispositions		
Properties at March 31	50	49
		Year Ended December 31, 2006
Properties at January 1		44
Consolidation of Rocky Mount MOB LLC		1
Acquisitions		6
Dispositions		(1)
Properties at December 31		50

The above tables excludes East Jefferson Medical Specialty Building, which is accounted for as a sales-type capital lease and includes Rocky Mount MOB, a consolidated entity owned 34.5% by the Company.

Comparison of the three months ended March 31, 2007 and March 31, 2006

Revenue. Total revenue increased \$3.3 million, or 26.0%, for the three months ended March 31, 2007 compared to three months ended March 31, 2006. This increase is primarily due to an increase in revenue of \$3.1 million related to rental revenue from properties acquired during 2006 and management fee and expense reimbursement revenue from Consera Healthcare Real Estate (Consera), which was acquired in September 2006. There was a minimal increase in same-store revenue and other income.

Table of Contents

Property operating and management expenses. Property operating and management expenses increased \$1.8 million, or 44.2%, for the three months ended March 31, 2007 compared to the three months ended March 31, 2006. This increase is primarily due to \$1.5 million of operating expenses related to properties acquired during 2006 and personnel and management costs at Consera. There was a minimal increase in same-store property operating and management expenses.

Interest expense. Interest expense, excluding changes in fair values of the interest rate swap agreements, for the three months ended March 31, 2007 was \$4.0 million compared to \$2.8 million for the three months ended March 31, 2006, an increase of \$1.2 million, or 42.9%. This increase is primarily due to the increased borrowing to fund the acquisitions during 2006 and increased variable interest rates.

Changes in interest rate swap fair values were recorded as a decrease or increase to interest expense until the swaps were terminated in November 2006. For the three months ended March 31, 2006, the interest rate swap agreements fair values increased by approximately \$0.4 million, which resulted in a reduction of interest expense of the same amount.

General and administrative expenses. General and administrative expenses increased \$0.3 million, or 12.8%, for the three months ended March 31, 2007 compared to the same period in 2006 primarily due to increased audit fees related to testing of management's assertion related to internal control compliance, timing of tax compliance professional services, income tax accruals related to development and management fees earned by the Company's taxable REIT subsidiaries, and expensing of previously capitalized costs associated with a development project that was discontinued. The reimbursement of these expensed costs is included in development fee revenue.

Cash Flows**Comparison of the three months ended March 31, 2007 and March 31, 2006**

Cash provided by operating activities was \$5.5 million and \$4.5 million during the three months ended March 31, 2007 and 2006, respectively. The increase of \$1.0 million was primarily due to (1) a \$0.1 million decrease in earnings before non-cash depreciation and amortizations and changes in fair value of interest rate swap agreements offset by (2) a \$1.1 million net increase due to changes in operating assets and liabilities primarily resulting from an increase in accrued expenses and prepaid rent as of March 31, 2007 as compared to the prior year.

Cash used in investing activities was \$8.1 million and \$71.7 million during the three months ended March 31, 2007 and 2006, respectively. The decrease of \$63.6 million was primarily due to the acquisition of four properties in the first three months ended March 31, 2006 compared to no acquisition in the first quarter of 2007. Investment in real estate properties for the first quarter of 2007 primarily consisted of development project expenditures.

Cash provided by financing activities was \$6.5 million and \$61.3 million for the three months ended March 31, 2007 and 2006, respectively. The decrease of \$54.8 million was primarily due to decreased financing needed due to decreased property acquisitions. During the first quarter of 2006, the Company obtained \$68.3 million of financing from the Credit Facility to fund the acquisition of four properties. In the first quarter of 2007, the Company had no acquisitions and the net cash provided by financing activities was primarily used to fund development projects.

Construction in Progress

Construction in progress at March 31, 2007 consisted of four development projects, Carolina Forest Medical Plaza, Lancaster Rehabilitation Hospital, Lancaster General Health Campus MOB, and Mebane Medical Office Building. The following is a summary of the construction in progress balance (dollars in thousands):

Table of Contents

Property	Location	Estimated Completion Date	Net Rentable Square Feet	Investment to Date	Estimated Total Investment
Carolina Forest Medical Plaza	Horry County, SC	2Q 2007	39,000	\$ 5,840	\$ 7,400
Lancaster Rehabilitation Hospital	Lancaster, PA	2Q 2007	52,800	8,867	12,300
Lancaster General Health Campus MOB	Lancaster, PA	4Q 2007	64,070	3,837	13,500
Mebane Medical Office Building	Mebane, NC	2Q 2008	60,000	898	16,200
Land and pre-construction developments				1,007	
			215,870	\$ 20,449	\$ 49,400

In March 2007, the Company obtained construction financing related to the Lancaster General Health Campus MOB project. The facility provides financing up to \$11.0 million and will convert to permanent financing at the date of occupancy. The mortgage note payable will mature five or seven years, at the Company's option, from the date of occupancy and provides for principal payments based on a 25 year amortization.

Liquidity and Capital Resources

As of March 31, 2007, the Company had \$5.0 million available in cash and cash equivalents. The Company will be required to distribute at least 90% of the Company's net taxable income, excluding net capital gains, to the Company's stockholders on an annual basis due to qualification requirements as a REIT. Therefore, as a general matter, it is unlikely that the Company will have any substantial cash balances that could be used to meet the Company's liquidity needs. Instead, these needs must be met from cash generated from operations and external sources of capital.

The Company has a \$130.0 million unsecured revolving Credit Facility with a syndicate of financial institutions (including Bank of America, N.A., Citicorp North America, Inc. and Branch Banking & Trust Company) (collectively, the Lenders). The Credit Facility is available to fund working capital and for other general corporate purposes; to finance acquisition and development activity; and to refinance existing and future indebtedness. The Credit Facility permits the Company to borrow up to \$130.0 million of revolving loans, with sub-limits of \$25.0 million for swingline loans and \$25.0 million for letters of credit.

The Credit Facility shall terminate and all amounts outstanding thereunder shall be due and payable in full, three years from November 1, 2005, subject to a one-year extension at the Company's option. The Credit Facility also allows for up to \$120.0 million of increased availability (to a total aggregate available amount of \$250.0 million), at the Company's option but subject to each Lender's option to increase its commitment. The interest rate on loans under the Credit Facility equals, at the Company's election, either (1) LIBOR plus a margin of between 100 to 130 basis points based on the Company's leverage ratio or (2) the higher of the federal funds rate plus 50 basis points or Bank of America, N.A.'s prime rate.

The Credit Facility contains customary terms and conditions for credit facilities of this type, including: (1) limitations on the Company's ability to (A) incur additional indebtedness, (B) make distributions to the Company's stockholders, subject to complying with REIT requirements, and (C) make certain investments; (2) maintenance of a pool of unencumbered assets subject to certain minimum valuations thereof; and (3) requirements for us to maintain certain financial coverage ratios. These customary financial coverage ratios and other conditions include a maximum leverage ratio (65%, with flexibility for one two quarter increase to not more than 75%), minimum fixed charge coverage ratio (150%), maximum combined secured indebtedness (50%), maximum recourse indebtedness (15%), maximum unsecured indebtedness (60%, with flexibility for one two quarter increase to not more than 75%), minimum unencumbered interest coverage ratio (175%, with the flexibility for one two quarter decrease to 150%) and minimum combined tangible net worth (\$30 million plus 85% of net proceeds of equity issuances by the Company and its subsidiaries after November 1, 2005).

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As of March 31, 2007, there was \$118.5 million available under the Credit Facility. There was \$11.5 million outstanding at March 31, 2007 and \$2.2 million of availability is restricted related to outstanding letters of credit. Subsequent to March 31, 2007, the Company had net borrowings of \$6.5 million to fund the quarterly distribution and development projects.

The Company believes that it will have sufficient capital resources as a result of operations and the borrowings in place to fund ongoing operations.

Table of Contents

On March 20, 2007, the Company declared a dividend to common stockholders of record and the Operating Partnership declared a distribution to unitholders of record, in each case as of April 5, 2007, totaling \$5.8 million or \$0.35 per share or unit, covering the period from January 1, 2007 through March 31, 2007. The dividend and distribution were paid on April 19, 2007. The dividend and distribution were equivalent to an annual rate of \$1.40 per share and OP unit.

Long-Term Liquidity Needs

The Company's principal long-term liquidity needs consist primarily of new property development, property acquisitions, principal payments under various mortgages and other credit facilities and non-recurring capital expenditures. The Company does not expect that its net cash provided by operations will be sufficient to meet all of these long-term liquidity needs. Instead, the Company expects to finance new property developments through modest cash equity capital contributed by the Company together with construction loan proceeds, as well as through cash equity investments by its tenants. The Company expects to fund property acquisitions through a combination of borrowings under its Credit Facility and traditional secured mortgage financing. In addition, the Company expects to use OP units issued by the Operating Partnership to acquire properties from existing owners seeking a tax deferred transaction. The Company expects to meet other long-term liquidity requirements through net cash provided by operations and through additional equity and debt financings, including loans from banks, institutional investors or other lenders, bridge loans, letters of credit, and other lending arrangements, most of which will be secured by mortgages. The Company may also issue unsecured debt in the future. However, in view of the Company's strategy to grow its portfolio over time, the Company does not, in general, expect to meet its long-term liquidity needs through sales of its properties. In the event that, notwithstanding this intent, the Company was in the future to consider sales of its properties from time to time, the proceeds that would be available to the Company from such sales, may be reduced by amounts that the Company may owe under the tax protection agreements entered into in connection with the Formation Transactions or those properties would need to be sold in a tax deferred transaction which would require reinvestment of the proceeds in another property. In addition, the Company's ability to sell certain of its assets could be adversely affected by the general illiquidity of real estate assets and certain additional factors particular to the Company's portfolio such as the specialized nature of its target property type, property use restrictions and the need to obtain consents or waivers of rights of first refusal or rights of first offers from ground lessors in the case of sales of its properties that are subject to ground leases.

The Company intends to repay indebtedness incurred under its Credit Facility from time to time, for acquisitions or otherwise, out of cash flow and from the proceeds of additional debt or equity issuances. In the future, the Company may seek to increase the amount of the Credit Facility, negotiate additional credit facilities or issue corporate debt instruments. Any indebtedness incurred or issued by the Company may be secured or unsecured, short-, medium- or long-term, fixed or variable interest rate and may be subject to other terms and conditions the Company deems acceptable. The Company intends to refinance at maturity the mortgage notes payable that have balloon payments at maturity.

Contractual Obligations

The following table summarizes the Company's contractual obligations as of March 31, 2007, including the maturities and scheduled principal repayments and the commitments due in connection with the Company's ground leases and operating leases for the periods indicated (in thousands):

	Through Remainder of 2007	2008	2009	2010	2011	Thereafter	Total
Obligation:							
Long-term debt principal payments and maturities ⁽¹⁾	\$ 48,720	\$ 50,657	\$ 46,438	\$ 1,456	\$ 3,562	\$ 43,035	\$ 193,868
Standby letters of credit ⁽²⁾	2,199						2,199

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Interest payments ⁽³⁾	8,965	8,235	5,258	2,938	2,692	1,316	29,404
Ground leases ⁽⁴⁾	146	195	195	195	195	6,781	7,707
Operating leases ⁽⁵⁾	251	403	406	350	354	30	1,794
Total	\$ 60,281	\$ 59,490	\$ 52,297	\$ 4,939	\$ 6,803	\$ 51,162	\$ 234,972

(1) Includes notes payable under the Company's Credit Facility

(2) As collateral for performance on a mortgage note payable, the Company is contingently liable under a standby letter of credit, which also reduces the availability under the Credit Facility

(3) Assumes one-month LIBOR 5.20% and Prime Rate of 8.25%

Table of Contents

- (4) Substantially all of the ground leases effectively limit our control over various aspects of the operation of the applicable property, restrict our ability to transfer the property and allow the lessor the right of first refusal to purchase the building and improvements. All of the ground leases provide for the property to revert to the lessor for no consideration upon the expiration or earlier termination of the ground lease.
- (5) Payments under operating lease agreements relate to various of our properties equipment and office space leases. The future minimum lease commitments under these leases are as indicated.

Off-Balance Sheet Arrangements

The Company guarantees debt in connection with certain of its development activities, including joint ventures. The Company has guaranteed, in the event of a default, the mortgage note payable for one unconsolidated real estate joint

venture. An initial liability of \$0.1 million has been recorded for the guarantee using expected present value measurement techniques. The guarantee, which has a principal balance of \$9.0 million at March 31, 2007, will be released upon the full repayment of the mortgage note payable, which matures in December 2007. The mortgage is collateralized by property and the collateral will revert to the guarantor in the event the guarantee is performed. Management believes the probability the Company will have to perform on the guarantee in the future is minimal and therefore the Company does not expect the Company's guarantee to have a material impact on the Company's financial statements.

Real Estate Taxes

The Company's leases generally require the tenants to be responsible for all real estate taxes.

Inflation

Inflation in the United States has been relatively low in recent years and did not have a material impact on the results of operations for the periods shown in the consolidated and combined financial statements. Although the impact of inflation has been relatively insignificant in recent years, it remains a factor in the United States economy and may increase the cost of acquiring or replacing properties.

Seasonality

The Company does not consider its business to be subject to material seasonality fluctuations.

Recent Accounting Pronouncements

In June 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, an interpretation of SFAS No. 109 (FIN 48), which clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109. FIN 48 prescribes a comprehensive model for how companies should recognize, measure, present, and disclose in their financial statements uncertain tax positions taken or expected to be taken in an income tax return. For those benefits recognized, a tax position must be more-likely-than-not to be sustained based solely upon the technical merits of the position. Such tax positions shall initially and subsequently be measured as the largest amount of tax benefit that, on a cumulative basis, is greater than 50% likely of being realized upon ultimate settlement with the tax authority assuming that the taxing authority has full knowledge of the position and all relevant facts. The Company implemented FIN 48 effective January 1, 2007. The adoption of FIN 48 did not result in an adjustment to the Company's financial statements.

In September 2006, the FASB issued SFAS No. 157 *Fair Value Measurements* (SFAS 157). SFAS 157 defines fair value for assets and liabilities, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS 157 is effective January 1, 2008. SFAS 157 is not expected to have a material impact on the Company's results of operations or financial position.

In September 2006, the FASB issued SFAS No. 158 *Employer's Accounting for Defined Benefit Pension and Other Postretirement Plans* an amendment of FASB Statements No. 87, 88, 106, and 132(R) (SFAS 158). SFAS 158 requires recognition of the funded status of such plans as an asset or liability, with changes in the funded status recognized through comprehensive income in the year in which they occur. These provisions of SFAS 158 are effective December 31, 2006. Additionally, SFAS 158 requires measurement of a plan's assets and its obligations at the end of the employer's

Table of Contents

fiscal year, effective December 31, 2008. SFAS 158 has not had, and is not expected to have, a material impact on the Company's results of operations or financial position.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of FASB Statement No. 115" (SFAS 159). SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. SFAS 159 does not affect any existing accounting literature that requires certain assets and liabilities to be carried at fair value. SFAS 159 is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact of the adoption of this new standard on its financial statements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company's future income, cash flows and fair values relevant to financial instruments are dependent upon prevalent market interest rates. Market risk refers to the risk of loss from adverse changes in market prices and interest rates. The Company uses some derivative financial instruments to manage, or hedge, interest rate risks related to the Company's borrowings. The Company does not use derivatives for trading or speculative purposes and only enters into contracts with major financial institutions based on their credit rating and other factors.

As of March 31, 2007, the Company had \$193.9 million of consolidated debt outstanding (excluding any discounts or premiums related to assumed debt). Of the Company's total consolidated debt, \$48.6 million, or 25.1%, was variable rate debt that are not subject to variable to fixed rate interest rate swap agreements. Of the Company's total indebtedness, \$145.3 million, or 74.9%, was subject to fixed interest rates, including variable rate debt that is subject to variable to fixed rate swap agreements.

If LIBOR were to increase by 100 basis points, the increase in interest expense on the Company's variable rate debt would decrease future annual earnings and cash flows by approximately \$0.5 million. Interest rate risk amounts were determined by considering the impact of hypothetical interest rates on the Company's financial instruments. These analyses do not consider the effect of any change in overall economic activity that could occur in that environment. Further, in the event of a change of that magnitude, the Company may take actions to further mitigate the Company's exposure to the change. However, due to the uncertainty of the specific actions that would be taken and their possible effects, these analyses assume no changes in the Company's financial structure.

ITEM 4. CONTROLS AND PROCEDURES

The Company's Chief Executive Officer and Chief Financial Officer, based on the evaluation of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities and Exchange Act of 1934, as amended) required by paragraph (b) of Rule 13a-15 or Rule 15d-15, have concluded that as of the end of the period covered by this report, the Company's disclosure controls and procedures were effective to give reasonable assurances to the timely collection, evaluation and disclosure of information relating to the Company that would potentially be subject to disclosure under the Securities Exchange Act of 1934, as amended, and the rules and regulations promulgated thereunder.

During the three month period ended March 31, 2007, there was no change in the Company's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Notwithstanding the foregoing, a control system, no matter how well designed and operated, can provide only reasonable, not absolute assurance that it will detect or uncover failures within the Company to disclose material information otherwise required to be set forth in our periodic reports.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The Company is not involved in any material litigation nor, to the Company's knowledge, is any material litigation pending or threatened against us, other than routine litigation arising out of the ordinary course of business or which is expected to be covered by insurance and not expected to harm the Company's business, financial condition or results of operations.

Table of Contents

ITEM 1A. RISK FACTORS

See the Company's Annual Report on Form 10-K for the year ended December 31, 2006, for risk factors. There have been no significant changes to the Company's risk factors during the three months ended March 31, 2007.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITIES HOLDERS

None.

ITEM 5. OTHER INFORMATION

None.

Table of Contents

ITEM 6. EXHIBITS

31.1 Certification of Chief Executive Officer pursuant to Section 302 of Sarbanes-Oxley Act of 2002.

31.2 Certification of Chief Financial Officer pursuant to Section 302 of Sarbanes-Oxley Act of 2002.

32.1 Certification of Chief Executive and Chief Financial Officer pursuant to 18 U.S.C. Section 1350 as adapted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

20

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

COGDELL SPENCER INC.
Registrant

Date: May 10, 2007

/s/Frank C. Spencer
Frank C. Spencer
President and Chief Executive Officer

Date: May 10, 2007

/s/Charles M. Handy
Charles M. Handy
Senior Vice President and Chief Financial Officer