

FRANKLIN STREET PROPERTIES CORP /MA/  
Form 10-Q/A  
July 29, 2004

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q/A  
(Amendment No. 1)

(Mark One)

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

For the quarterly period ended March 31, 2004

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File No. 0-32615

FRANKLIN STREET PROPERTIES CORP.  
(Exact name of registrant as specified in its charter)

Maryland  
(State or other jurisdiction of  
incorporation or organization)

04-3578653  
(I.R.S. Employer  
Identification No.)

401 Edgewater Place, Suite 200, Wakefield, Massachusetts  
(Address of principal executive offices)

01880-6210  
(Zip Code)

Registrant's telephone number, including area code: (781) 557-1300

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 an accelerated filer as  
defined by Rule 12b-2 of the Securities Exchange Act of 1934, as amended.  
Yes  No .

The number of shares of common stock outstanding as of March 10, 2004 was  
49,630,338.

#### EXPLANATORY NOTE

The purpose of this Amendment No. 1 to the Form 10-Q for the quarterly  
period ended March 31, 2004 is solely to amend Exhibits 31.1 and 31.2, of which  
paragraphs 4 and 5 were inadvertently omitted in both exhibits. The registrant  
has included amended and restated Exhibits 31.1 and 31.2, as of the date  
originally certified, as Exhibit 31.1 and 31.2 hereto. The registrant has also  
included Exhibits 31.3 and 31.4 as certifications with respect to this 10-Q/A.

Other than as described above, there have been no changes to the Quarterly  
Report on Form 10-Q, which is included in full herein.

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Franklin Street Properties Corp.

Form 10-Q

Quarterly Report  
March 31, 2004

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

Franklin Street Properties Corp.  
Consolidated Balance Sheets  
(unaudited)

March 31, December 31

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(in thousands, except share and par value amounts)

2004

2003

Assets:

Real estate assets:

Land	\$ 71,236	\$ 71,236
Buildings and improvements	403,343	403,243
Fixtures and equipment	889	889

	475,468	475,368
Less accumulated depreciation	28,555	25,836

Real estate assets, net	446,913	449,532
-------------------------	---------	---------

Acquired real estate leases, less accumulated amortization of \$1,999 and \$1,539, respectively

7,504 7,964

Assets held for syndication

-- 4,117

Cash and cash equivalents

53,950 58,793

Restricted cash

968 982

Tenant rent receivables, less allowance for doubtful accounts of \$155 and \$155, respectively

1,110 881

Straight-line rent receivable, less allowance for doubtful accounts of \$360 and \$360, respectively

4,427 4,087

Prepaid expenses

970 806

Investment in non-consolidated REITs

4,292 --

Office computers and furniture, net of accumulated depreciation of \$484 and \$473, respectively

404 398

Deferred leasing commissions, net of accumulated amortization of \$655 and \$586, respectively

1,051 969

Total Assets	\$521,589	\$528,529
--------------	-----------	-----------

Liabilities and Stockholders' Equity:

Liabilities:

Bank note payable	\$ --	\$ 4,117
Accounts payable and accrued expenses	5,502	5,030
Accrued compensation	411	1,545
Tenant security deposits	968	982

Total Liabilities	6,881	11,674
-------------------	-------	--------

Commitments and Contingencies:

Stockholders' Equity:

Preferred Stock, \$.0001 par value, 20,000,000 shares authorized, none issued or outstanding	--	--
Common Stock, \$.0001 par value, 180,000,000 shares authorized, 49,630,338 shares issued and outstanding	5	5
Additional paid-in capital	512,813	512,797
Retained earnings	1,484	3,647
Accumulated undistributed net realized gain on sale of properties	406	406

Total Stockholders' Equity	514,708	516,855
----------------------------	---------	---------

Total Liabilities and Stockholders' Equity	\$521,589	\$528,529
--	-----------	-----------

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

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Franklin Street Properties Corp.  
Consolidated Statements of Income  
(Unaudited)

	For the Three Months Ended March 31,	
(in thousands, except per share amounts)	2004	2003
=====		
Revenue:		
Rental	\$18,045	\$ 5,399
Syndication fees	3,041	3,233
Transaction fees	3,549	3,215
Sponsored REIT income	1,669	384
Other	350	317
-----		
Total revenue	26,654	12,548
-----		
Expenses:		
Real estate operating expenses	3,299	1,433
Real estate taxes and insurance	2,320	697
Depreciation and amortization	3,200	830
Sponsored REIT expenses	1,043	291
Selling, general and administrative	1,526	1,398
Commissions	1,520	1,616
Shares issued as compensation	162	--
Interest	264	331
-----		
Total expenses	13,334	6,596
-----		
Income before interest income and taxes on income	13,320	5,952
Interest income	227	49
-----		
Income before taxes on income	13,547	6,001
Taxes on income	328	229
-----		
Income from continuing operations	13,219	5,772
Income from discontinued operations	--	95
Gain on sale of properties, less applicable income tax	--	1,421
-----		

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Net income	\$13,219	\$ 7,288
=====		
Weighted average number of shares outstanding, basic and diluted	49,624	24,630
=====		
Amounts per share, basic and diluted, attributable to		
Continuing operations	\$ 0.27	\$ 0.23
Discontinued operations	--	--
Gain on sale of properties, less applicable income tax	--	0.06
-----		
Net income per share, basic and diluted	\$ 0.27	\$ 0.29
=====		

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

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Franklin Street Properties Corp.  
Consolidated Statements of Cash Flows  
(Unaudited)

	For the Three Months Ended March 31,	
	2004	2003
(in thousands, except per share amounts)	-----	-----
Cash flows from operating activities:		
Net income	\$ 13,219	\$ 7,288
Adjustments to reconcile net income to net cash provided by (used for) operating activities:		
Depreciation and amortization	3,259	931
Gain on sale of real estate assets	--	(1,421)
Shares issued as compensation	162	--
Income from non-consolidated REITs	(44)	--
Changes in operating assets and liabilities:		
Restricted cash	14	41
Tenant rent receivable, net	(229)	44
Straight-line rent receivables, net	(340)	450
Prepaid expenses	(164)	33
Accounts payable and accrued expenses	472	(243)
Accrued compensation	(1,134)	(451)
Tenant security deposits	(14)	(41)
Payment of deferred leasing commissions	(151)	(56)
-----		
Net cash provided by (used for) operating activities	15,050	6,575
-----		
Cash flows from investing activities:		
Purchase of real estate assets, office computers and furniture	(117)	(183)

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Investment in non-consolidated REITs	(4,248)	--
Changes in deposits on real estate assets	--	290
Purchase of (sale of) assets held for syndication	4,117	(25,309)
Proceeds received on sale of real estate assets	--	6,228
-----		
Net cash provided by (used for) investing activities	(248)	(18,974)
-----		
Cash flows from financing activities:		
Distributions to stockholders	(15,382)	(7,635)
Proceeds from (payments to) bank note payable, net	(4,117)	23,979
Purchase of treasury stock	(146)	--
-----		
Net cash provided by (used for) financing activities	(19,645)	16,344
-----		
Net increase (decrease) in cash and cash equivalents	(4,843)	3,945
Cash and cash equivalents, beginning of period	58,793	22,316
-----		
Cash and cash equivalents, end of period	\$ 53,950	\$ 26,261
=====		

Supplemental disclosure of cash flow information:

Cash paid for:		
Interest	\$ 264	\$ 331
Taxes on income	\$ 100	\$ 585

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

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Franklin Street Properties Corp.  
Notes to Consolidated Financial Statements  
(Unaudited)

1. Organization, Properties, Basis of Presentation and Recent Accounting Pronouncements

Organization

Franklin Street Properties Corp. (together with its subsidiaries, "FSP Corp." or the "Company", known as Franklin Street Partners Limited Partnership, or the "Partnership", prior to January 1, 2002) was formed as a Massachusetts limited partnership on February 4, 1997. Prior to July 1, 2001 the Partnership owned a 99% interest in FSP Investments LLC ("FSP Investments"), a 99% interest in FSP Property Management LLC ("FSP Property Management") and 100% of FSP Holdings LLC ("FSP Holdings"). Effective July 1, 2001, FSP Holdings purchased the remaining 1% interest of FSP Investments and FSP Property Management for approximately \$32,000. As of March 31, 2004, the Company also has a non-controlling interest in nine corporations organized to operate as real estate investment trusts ("REITs").

In December 2001, the limited partners of the Partnership approved the

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conversion of the Partnership from a partnership into a corporation (the "Conversion"). The Conversion was effective January 1, 2002, and was accomplished as tax-free reorganization by merging the Partnership with and into a wholly owned subsidiary, Franklin Street Properties Corp., with the subsidiary as the surviving entity. In 2002, the Company elected to be taxed as a real estate investment trust ("REIT"). As part of the Conversion, all of the Partnership's outstanding units were converted on a one-for-one basis into 24,586,249 shares of common stock of the Company. The Conversion was accounted for as a reorganization of affiliated entities, with assets and liabilities recorded at their historical costs.

On May 30, 2003, the shareholders of the Company approved the Company's acquisition by merger of 13 REITs (the "Target REITs"). The mergers were effective June 1, 2003 and, as a result, the Company issued approximately 25,000,091 shares in a tax-free exchange for all the outstanding preferred shares of the Target REITs. The mergers were accounted for as a purchase and the acquired assets and liabilities were recorded at their fair value.

The Company operates in two business segments: real estate operations and investment banking/investment services. As part of the Company's real estate operations segment, FSP Property Management provides asset management and property management services for the Sponsored REITs. As part of the Company's investment banking/investment services segment, FSP Investments provides real estate investment and broker/dealer services. FSP Investments' services include: (i) the organization of REIT entities (the "Sponsored REITs"), which are syndicated through private placements; (ii) the acquisition of real estate on behalf of the Sponsored REITs; and (iii) the sale of preferred stock in Sponsored REITs.

### Properties

The following table summarizes the Company's investment in real estate assets, excluding assets held for syndication:

	As of March 31,	
	2004	2003
Residential real estate		
Number of properties	4	3
Number of apartments	837	558
Commercial real estate		
Number of properties	24	13
Square feet	3,049,357	1,433,300

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Franklin Street Properties Corp.  
Notes to Consolidated Financial Statements  
(Unaudited)

1. Organization, Properties, Basis of Presentation and Recent Accounting Pronouncements (continued)

#### Basis of Presentation

The unaudited consolidated financial statements of the Company include all the accounts of the Company and its wholly and majority owned subsidiaries. All significant intercompany balances and transactions have been eliminated. These

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financial statements should be read in conjunction with the Company's financial statements and notes thereto contained in the Company's Annual Report on Form 10-K for its fiscal year ended December 31, 2003.

The accompanying interim financial statements are unaudited; however, the financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and in conjunction with the rules and regulations of the Securities and Exchange Commission. Accordingly, they do not include all of the disclosures required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting solely of normal recurring matters) necessary for a fair presentation of the financial statements for these interim periods have been included.

Certain prior-year balances have been reclassified in order to conform to the current-year presentation.

### Recent Accounting Standards

In January 2003, the FASB issued FASB Interpretation No. 46 ("FIN 46"), Consolidation of Variable Interest Entities. In December 2003, the FASB revised FIN 46 with certain modifications and clarifications. The objective of this interpretation is to provide guidance on how to identify a variable interest entity ("VIE") and determine when the assets, liabilities, non-controlling interests, and results of operations of a VIE need to be included in a company's consolidated financial statements. A VIE exists when either the total equity investment at risk is not sufficient to permit the entity to finance its activities by itself, or the equity investors lack one of three characteristics associated with owning a controlling financial interest. Application of this guidance was effective for interests in certain VIEs commonly referred to as special-purpose entities (SPEs) as of December 31, 2003. The provisions of this interpretation became effective upon issuance. The adoption of this standard did not have a material impact on the Company's financial position, operations or cash flow.

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Franklin Street Properties Corp.  
Notes to Consolidated Financial Statements  
(Unaudited)

### 2. Investment Banking/Investment services Activity

During the three months ended March 31, 2004, the Company completed the syndication of a Sponsored REIT, FSP Blue Lagoon Drive Corp., which had been started in the fourth quarter of 2003. The Company also completed the syndication of another Sponsored REIT, FSP Eldridge Green Corp., which had acquired an office building in Houston, Texas. The Company sold on a best efforts basis, through private placements, approximately \$49,175,000 in preferred stock in these Sponsored REITs in the three months ending March 31, 2004.

The Company has in the past acquired by merger entities similar to the Sponsored REITs. The Company's business model includes the potential acquisition by merger in the future of Sponsored REITs. However, the Company has no legal or any other enforceable obligation to acquire or to offer to acquire any Sponsored REIT. In addition, any offer (and the related terms and conditions) that might be made in the future to acquire any Sponsored REIT would require the approval of the boards of directors of the Company and the Sponsored REIT, the approval of the



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shareholders of the Sponsored REIT, and any such acquisition may also require the approval of the shareholders of the Company.

### 3. Related Party Transactions and Investments in Non-consolidated Entities

The Company typically purchases and retains a non-controlling common stock ownership interest in Sponsored REITs that it has organized. These ownership interests have virtually no economic benefit or risk. In January 2004 the Company also purchased 49.25 preferred shares or 8.22% of FSP Blue Lagoon Drive Corp. for \$4,248,000 (\$4,925,000 less non-recorded commissions of \$394,000 and loan fees of \$283,000). At March 31, 2004, December 31, 2003 and March 31, 2003, the Company had ownership interests in nine, eight and eighteen Sponsored REITs, respectively.

Summarized financial information for the Sponsored REITs is as follows:

	March, 31 2004	December 31, 2003
	-----	-----
(in thousands)		
Balance Sheet Data:		
-----		
Real estate, net	\$293,722	\$257,700
Other assets	57,207	53,646
Total liabilities	(4,833)	(18,129)
	-----	-----
Shareholders' equity	\$346,096	\$293,217
	=====	=====
	For the three months ended March 31,	
	2004	2003
	-----	-----
(in thousands)		
Operating Data:		
-----		
Rental revenue	\$13,006	\$15,667
Other revenue	120	108
Operating and maintenance expenses	(3,853)	(5,020)
Depreciation and amortization	(3,050)	(2,619)
Interest expense and commitment fees	(3,332)	(767)
	-----	-----
Net income	\$ 2,891	\$ 7,369
	=====	=====

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Franklin Street Properties Corp.  
Notes to Consolidated Financial Statements  
(Unaudited)

### 3. Related Party Transactions and Investments in Non-consolidated Entities (continued)

The Company's proportionate share of the Sponsored REITs' income and expenses prior to the completion of the syndication of these Sponsored REITs is summarized in the following table:

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(in thousands)	For the three months ended March 31,	
	2004	2003
	-----	-----
Sponsored REIT income	\$ 1,669	\$ 384
Sponsored REIT expense	(1,043)	(291)
	-----	-----
Net income	\$ 626	\$ 93
	=====	=====

Sponsored REIT income also includes \$44,000 for the three months ended March 31, 2004, which was the Company's share of income resulting from its interest in preferred stock of FSP Blue Lagoon Drive Corp.

The Company provides syndication and real estate acquisition advisory services for the Sponsored REITs at the times of their respective syndications. For the three months ended March 31, 2004 and 2003, respectively, syndication fees were approximately \$3.0 million and \$3.2 million, and transaction fees were approximately \$3.5 million and \$3.2 million.

Asset management fee income charged by the Company to the Sponsored REITs amounted to approximately \$115,000 and \$149,000 for the three months ended March 31, 2004 and 2003, respectively, and is included in "Other" in the consolidated statements of income. Management fees range from 1% to 5% of collected rents and the applicable contracts are cancelable with 30 days notice.

4. Bank Note Payable

The Company has a revolving line of credit agreement (the "Loan Agreement") with a group of banks providing for borrowings at the Company's election of up to \$125,000,000. Borrowings under the Loan Agreement bear interest at either the bank's base rate or a variable LIBOR rate, as defined. The balance outstanding was \$0 and \$4,117,000 as of March 31, 2004 and December 31, 2003, respectively.

The Loan Agreement includes restrictions on property liens and requires compliance with various financial covenants. Financial covenants include the maintenance of at least \$1,500,000 in operating cash accounts, a minimum tangible net worth and compliance with various debt and operating income ratios, as defined in the Loan Agreement. The Company was in compliance with the Loan Agreement's financial covenants as of March 31, 2004. The Loan Agreement matures on August 18, 2005.

5. Net Income Per Share

Basic net income per share is computed by dividing net income by the weighted average number of Company shares outstanding during the period. Diluted net income per share reflects the potential dilution that could occur if securities or other contracts to issue shares were exercised or converted into shares. There were no potential dilutive shares outstanding at March 31, 2004 and 2003.

6. Business Segments

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The Company operates in two business segments: real estate operations (including real estate leasing, interim acquisition financing and asset/property management) and investment banking/investment services (including real estate acquisition and broker/dealer services). The Company has identified these segments because this discrete information is the basis upon which management makes decisions regarding resource allocation and performance assessment. The accounting policies of the reportable segments are the same as those described in the "Significant Accounting Policies" set forth in Note 2 to the Company's audited financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2003. The Company's segments are located in the United States of America.

The Company evaluates the performance of its reportable segments based on Cash Available for Distribution ("CAD") as management believes that CAD represents the most accurate measure of the reportable segment's activity and is the basis for distributions paid to equity holders. The Company defines CAD as: net income as computed in accordance with accounting principles generally accepted in the United States of America ("GAAP"); plus certain non-cash items included in the computation of net income (depreciation and amortization, gain or loss on the sale of real estate, unrealized income from non-consolidated REITs, certain non-cash compensation expenses and straight-line rent adjustments); plus the net proceeds from the sale of land; less purchases of property and equipment ("Capital Expenditures") and payments for deferred leasing commissions, plus proceeds from (payments to) cash reserves established at the acquisition date of the property. Depreciation and amortization, gain or loss on the sale of real estate, unrealized income from non-consolidated REITs, non-cash compensation and straight-line rents are an adjustment to CAD, as these are non-cash items included in net income. Capital expenditures, payments of deferred leasing commissions and the proceeds from (payments to) the funded reserve are an adjustment to CAD, as they represent cash items not reflected in net income.

The funded reserve represents funds that the Company has set aside in anticipation of future capital needs. These reserves are typically used for the payment of capital expenditures, deferred leasing commissions and certain tenant allowances; however, there are no legal restrictions on their use and they may be used for any Company purpose.

CAD should not be considered as an alternative to net income (determined in accordance with GAAP), as an indicator of the Company's financial performance, nor as an alternative to cash flows from operating activities (determined in accordance with GAAP), nor as a measure of the Company's liquidity, nor is it necessarily indicative of sufficient cash flow to fund all of the Company's needs. Other real estate companies may define CAD in a different manner. It is at the Company's discretion to retain a portion of CAD for operational needs. We believe that in order to facilitate a clear understanding of the results of the Company, CAD should be examined in connection with net income and cash flows from operating, investing and financing activities in the consolidated financial statements.

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Franklin Street Properties Corp.  
Notes to Consolidated Financial Statements  
(Unaudited)

### 6. Business Segments (continued)

The calculation of CAD by business segment is shown in the following table:

Investment

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(in thousands)	Real Estate Operations	Banking/ Investment Services	Total
	-----	-----	-----
Three Months Ended March 31, 2004			
Net Income	\$ 12,739	\$ 480	\$ 13,219
Depreciation and amortization	3,235	24	3,259
Straight line rent	(340)	--	(340)
Non-cash compensation expense	--	162	162
Capital expenditures	(100)	(17)	(117)
Payment of deferred leasing costs	(151)	--	(151)
Unrealized income from non-consolidated REITs	(44)	--	(44)
Proceeds from funded reserves	251	--	251
	-----	-----	-----
Cash Available for Distribution	\$ 15,590	\$ 649	\$ 16,239
	=====	=====	=====
Three Months Ended March 31, 2003			
Net Income	\$ 6,986	\$ 302	\$ 7,288
Depreciation and amortization	901	30	931
Straight line rent	432	--	432
Non-cash compensation expense	--	--	--
Loss (gain) on sale of property	(1,421)	--	(1,421)
Capital expenditures	(183)	--	(183)
Payment of deferred leasing costs	(53)	--	(53)
Proceeds from funded reserves	191	--	191
	-----	-----	-----
Cash Available for Distribution	\$ 6,853	\$ 332	\$ 7,185
	=====	=====	=====

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Franklin Street Properties Corp.  
Notes to Consolidated Financial Statements  
(Unaudited)

6. Business Segments (continued)

The following table is a summary of other financial information by business segment:

(in thousands)	Real Estate Operations	Investment Banking/ Investment Services	Total
	-----	-----	-----
Three Months Ended March 31, 2004:			
Revenue	\$ 22,892	\$3,762	\$ 26,654
Interest Income	211	16	227
Interest Expense	264	--	264
Capital Expenditures	100	17	117
Total assets at March 31, 2004	518,255	3,334	521,589
Three Months Ended March 31, 2003:			
Revenue	\$ 9,141	\$3,407	\$ 12,548

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Interest Income	28	21	49
Interest Expense	331	--	331
Income from discontinued operations, net	95	--	95
Gain on Sale of Properties	1,421	--	1,421
Capital Expenditures	183	--	183
Total assets at March 31, 2003	217,463	6,040	223,503

### 7. Cash Dividends

The Company declared and paid dividends as follows (in thousands, except per share amounts):

Quarter Paid	Dividends Per Share	Total Dividends
First quarter of 2004	\$ .31	\$15,382
First quarter of 2003	\$ .31	\$ 7,635

### 8. Income Taxes

The Company has elected to be taxed as a REIT under the Internal Revenue Code of 1986, as amended (the "Code"). As a REIT, the Company generally is entitled to a tax deduction for dividends paid to its shareholders, thereby effectively subjecting the distributed net income of the Company to taxation at the shareholder level only. The Company must comply with a variety of restrictions to maintain its status as a REIT. These restrictions include the type of income it can earn, the type of assets it can hold, the number of shareholders it can have and the concentration of their ownership, and the amount of the Company's income that must be distributed annually.

One such restriction is that the Company generally cannot own more than 10% of the voting power or value of the securities of any one issuer unless the issuer is itself a REIT or a "taxable REIT subsidiary" ("TRS"). In the case of TRSs, the Company's ownership of securities in all TRSs generally cannot exceed 20% of the value of all of the Company's assets and, when considered together with other non-real estate assets, cannot exceed 25% of the value of all of the Company's assets. Effective January 1, 2001, a subsidiary of the Company has elected to be treated as a TRS. As a result, FSP Investments operates as a taxable corporation under the Code and has accounted for income taxes in accordance with the provisions of Statement of Financial Accounting Standard ("SFAS") No. 109, Accounting for Income Taxes. Taxes are provided when FSP investments has net profits for both financial statement and income tax purposes.

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Franklin Street Properties Corp.  
Notes to Consolidated Financial Statements  
(Unaudited)

### 8. Income Taxes (continued)

Income taxes are recorded based on the future tax effects of the difference between the tax and financial reporting bases of the Company's assets and liabilities. In estimating future tax consequences, potential future events are considered except for potential changes in income tax law or in rates.

The income tax expense reflected in the consolidated statements of income

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relates only to the TRS. The expense differs from the amounts computed by applying the Federal statutory rate of 35% to income before income taxes as follows:

(in thousands)	For the Three Months Ended	
	2004	2003
Federal income tax expense at statutory rate	\$ 283	\$ 195
Increase (decrease) in taxes resulting from:		
State income taxes, net of federal impact	45	34
	\$ 328	\$ 229

No deferred income taxes were provided as there were no temporary differences between the financial reporting basis and the tax basis of the taxable REIT subsidiary.

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Franklin Street Properties Corp.  
Notes to Consolidated Financial Statements  
(Unaudited)

9. Merger Transactions

On June 1, 2003, the Company issued approximately 25 million shares of common stock, \$0.0001 par value per share in exchange for all of the outstanding preferred stock of 13 Sponsored REITs it acquired by merger. The results of operations for each of the Sponsored REITs have been included in the Company's consolidated financial statements since that date. The merger transactions were structured as exchanges of shares and no cash was involved.

The aggregate purchase price was approximately \$321 million. On the acquisition date, for each Sponsored REIT, the increase between the appraised value of the property and the historical cost of the property was allocated to real estate investments and leases, including Lease origination costs. Lease origination costs represent the value associated with acquiring an in-place lease (i.e. the market cost to execute a similar lease, including leasing commission, legal, vacancy, and other related costs). The value assigned to buildings approximates their replacement cost; the value assigned to land approximates its appraised value; and the value assigned to leases approximates their fair value. Other assets and liabilities are recorded at their historical costs, which approximates fair value. The following table summarizes the estimated fair value of the assets acquired at the date of acquisition:

Pro forma operating results for the Company and the 13 Sponsored REITs the Company acquired during 2003 are shown in the following table. The results assume that the mergers occurred and the shares of the Company's stock were issued on January 1, 2003 and are not necessarily indicative of what the Company's actual results of operations would have been for the period indicated, nor do they purport to represent the results of operations of any future period.

(in thousands except per share amount)	For Three Months Ended March 31, 2003	
	-----	

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Revenue	\$ 24,064
Expenses	(12,346)
Interest income	121
Taxes on income	(229)
	-----
Net income from continuing operations	11,610
Income from discontinued operations	95
Gain on sale of property	1,421
	=====
Net income	\$ 13,126
	=====
Weighted average shares outstanding	49,630
	=====
Net income per share	\$ 0.26
	=====

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with the financial statements and notes thereto appearing elsewhere in this report and in our Annual Report on Form 10-K for the year ended December 31, 2003. Historical results and percentage relationships set forth in the Consolidated Statements of Income contained in the financial statements, including trends which might appear, should not be taken as necessarily indicative of future operations. This discussion may also contain forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, and Section 27A of the Securities Act of 1933, as amended. For purposes of these Acts, any statement that is not a statement of historical fact may be deemed a forward-looking statement. The forward-looking statements found in this Quarterly Report on Form 10-Q are based on current judgments and current knowledge of management, which are subject to certain risks, trends and uncertainties that could cause actual results to differ materially from those indicated in such forward-looking statements. Accordingly, readers are cautioned not to place undue reliance on forward-looking statements. Investors are cautioned that our forward-looking statements involve risks and uncertainty, including without limitation, changes in economic conditions in the markets in which we own properties, expectations with respect to individual properties owned by us, changes in the demand by investors for investment in Sponsored REITs, risks of a lessening of demand for the types of real estate owned by us, changes in government regulations, and expenditures that cannot be anticipated such as utility rate and usage increases, unanticipated repairs, additional staffing, insurance increases and real estate tax valuation reassessments. See the factors set forth below under the caption, "Certain Factors That May Affect Future Results". Although we believe the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. We will not update any of the forward-looking statements after the date this quarterly report is filed to conform them to actual results or to changes in our expectations that occur after such date, other than as required by law.

Overview

FSP Corp. operates in two business segments: real estate operations and investment banking/investment services. The real estate operations segment involves real estate rental operations, leasing, interim acquisition financing

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and asset/property management services. The investment banking/investment services segment involves the provision of real estate investment and broker/dealer services that include the organization of Sponsored REITs, the acquisition of real estate on behalf of Sponsored REITs and the syndication of Sponsored REITs through sale of preferred stock in private placements.

The main factor that affects our real estate operations is the broad economic market conditions in the United States. These market conditions affect the occupancy levels and the rent levels on both a national and local level. We have no influence on the national market conditions. We look to acquire quality properties in good locations in order to lessen the impact of downturns in the market and to take advantage of upturns when they occur.

Our investment banking/investment services customers are primarily institutions and high net-worth individuals. To the extent that the broad capital markets affect these investors our business is also affected. These investors have many investment choices. We must continually search for real estate at a price and at a competitive risk/reward rate of return that meets our customer's risk/reward profile for providing a stream of income and as a long-term hedge against inflation.

### Critical Accounting Policies

We have certain critical accounting policies that are subject to judgments and estimates by our management and uncertainties of outcome that affect the application of these policies. We base our estimates on historical experience and on various other assumptions we believe to be reasonable under the circumstances. On an on-going basis, we evaluate our estimates. In the event estimates or assumptions prove to be different from actual results, adjustments are made in subsequent periods to reflect more current information. The accounting policies that we believe are most critical to the understanding of our financial position and results of operations, and that require significant management estimates and judgments, are discussed below.

Critical accounting policies are those that have the most impact on the reporting of our financial condition and results of operations and those requiring significant judgments and estimates. We believe that our judgments and assessments are consistently applied and produce financial information that fairly presents our results of operations. Our most critical accounting policies involve our investments in real property and Sponsored REITs. These policies affect our:

- o allocation of purchase prices between various asset categories and the related impact on our recognition of rental income and depreciation and amortization expense;
- o assessment of the carrying values and impairments of long lived assets;
- o classification of leases; and
- o revenue recognition in the syndication of Sponsored REITs and the investment in non-consolidated REITs.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

Critical Accounting Policies (continued)



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### Allocation of Purchase Price

We have historically allocated the purchase prices of properties to land, buildings and improvements. Each component of purchase price generally has a different useful life. For properties acquired subsequent to June 1, 2001, the effective date of Statement of Financial Accounting Standards ("SFAS") No. 141 "Business Combinations," we allocate the value of real estate acquired among land, buildings, improvements and identified intangible assets and liabilities, which may consist of the value of above market and below market leases, the value of in-place leases, and the value of tenant relationships. Purchase price allocations and the determination of the useful lives are based on management's estimates. Under some circumstances we may rely upon studies commissioned from independent real estate appraisal firms.

Purchase price allocated to land and building and improvements is based on management's determination of the relative fair values of these assets assuming the property was vacant. Management determines the fair value of a property using methods similar to those used by independent appraisers. Purchase price allocated to above market leases is based on the present value (using an interest rate which reflects the risks associated with the leases acquired) of the difference between (i) the contractual amounts to be paid pursuant to the in-place leases and (ii) our estimate of fair market lease rates for the corresponding leases, measured over a period equal to the remaining non-cancelable terms of the respective leases. Purchase price allocated to in-place leases and tenant relationships is determined as the excess of (i) the purchase price paid for a property after adjusting existing in-place leases to market rental rates over (ii) the estimated fair value of the property as if vacant. This aggregate value is allocated between in-place lease values and tenant relationships and is based on management's evaluation of the specific characteristics of each tenant's lease; however, the value of tenant relationships has not been separated from in-place lease value because such value and its consequence to amortization expense is immaterial for acquisitions reflected in our financial statements. Factors considered by us in performing these analyses include (i) an estimate of carrying costs during the expected lease-up periods, including real estate taxes, insurance and other operating income and expenses and (ii) costs to execute similar leases in current market conditions, such as leasing commissions, legal and other related costs. If future acquisitions result in our allocating material amounts to the value of tenant relationships, those amounts would be separately allocated and amortized over the estimated life of the relationships.

### Depreciation Expense

We compute depreciation expense using the straight-line method over estimated useful lives of up to 40 years for buildings and improvements, and up to 15 years for personal property. The allocated cost of land is not depreciated. The capitalized above-market lease values (included in acquired real estate leases in our consolidated balance sheets) are amortized as a reduction to rental income over the remaining non-cancelable terms of the respective leases. We do not have any capitalized below market leases. The value of in-place leases, exclusive of the value of above-market and below-market in-place leases, is amortized over the remaining non-cancelable periods of the respective leases. If a lease is terminated prior to its stated expiration, all unamortized amounts relating to that lease are written off. Inappropriate allocation of acquisition costs, or incorrect estimates of useful lives, could result in depreciation and amortization expenses which do not appropriately reflect the allocation of our capital expenditures over future periods, as is required by generally accepted accounting principles.

### Impairment

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We periodically evaluate our real estate properties for impairment indicators. These indicators may include declining tenant occupancy, weak or declining tenant profitability, cash flow or liquidity, our decision to dispose of an asset before the end of its estimated useful life or legislative, economic or market changes that permanently reduce the value of our investments. If indicators of impairment are present, we evaluate the carrying value of the property by comparing it to its expected future undiscounted cash flows. If the sum of these expected future cash flows is less than the carrying value, we reduce the net carrying value of the property to the present value of these expected future cash flows. This analysis requires us to judge whether indicators of impairment exist and to estimate likely future cash flows. If we misjudge or estimate incorrectly or if future tenant profitability, market or industry factors differ from our expectations, we may record an impairment charge which is inappropriate or fail to record a charge when we should have done so, or the amount of such charges may be inaccurate.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

Critical Accounting Policies (continued)

### Lease Classification

Some of our real estate properties are leased on a triple net basis, pursuant to non-cancelable, fixed term, operating leases. Each time we enter a new lease or materially modify an existing lease, we evaluate whether it is appropriately classified as a capital lease or as an operating lease. The classification of a lease as capital or operating affects the carrying value of a property, as well as our recognition of rental payments as revenue. These evaluations require us to make estimates of, among other things, the remaining useful life and market value of a property, discount rates and future cash flows. Incorrect assumptions or estimates may result in misclassification of our leases.

### Revenue Recognition

We earn syndication and transaction fees in connection with the syndication of Sponsored REITs. This revenue is recognized pursuant to the provisions of SFAS No. 66 "Accounting for Sales of Real Estate," and Statement of Position 92-1 "Accounting for Real Estate Syndication Income." Revenue is recognized provided the criteria for sale accounting in SFAS No. 66 are met. Accordingly, we recognize syndication fees related to commissions when shares of the Sponsored REIT are sold and the investor's funds have been transferred from escrow into our account. We recognize transaction fees related to loan commitment fees upon an investor closing and the subsequent payment of the Sponsored REIT's loan to the Company. Other transaction fees are recognized upon the final syndication of the Sponsored REIT.

### Ownership of Stock in a Sponsored REIT

We typically purchase and retain a common stock ownership in a Sponsored REIT following syndication, and earn an ongoing asset and/or property management fee. Accordingly, transaction fee revenue and our share of the operations of these Sponsored REITs are not classified as discontinued operations due to our continuing involvement.

Our investment in non-consolidated REITs represents our investment in the common and preferred stock in Sponsored REITs. We account for these investments using the equity method of accounting as we exercise significant influence over, but

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do not control, these entities. Under the equity method of accounting we record our percentage share of net earnings from these investments and our investment balance of these entities is subsequently adjusted. Equity in the losses of these entities is not recognized to the extent that the investment balance would become negative. Dividends are recognized as income after the investment balance is reduced to zero.

Under the equity method, accounting policy judgments made by the Sponsored REITs could have a material affect on our net income. Also, if we determine that there is an other than temporary decline in the fair value of any of these investments, its investment balance would be written down to fair value and the amount of the write down would be included in our earnings. In evaluating the fair value of these investments, we have considered, among other things, the financial condition and near term prospects of the investment, earnings trends, asset quality, asset valuation models, and the financial condition and prospects for its industry.

### Summary

These policies involve significant judgments made based upon our experience, including judgments about current valuations, ultimate realizable value, estimated useful lives, salvage or residual value, the ability of our tenants to perform their obligations to us, current and future economic conditions and competitive factors in the markets in which our properties are located. Recent declines in our occupancy percentages at some of our properties reflect current economic conditions and competition. Competition, economic conditions and other factors may cause additional occupancy declines in the future. In the future we may need to revise our carrying value assessments to incorporate information which is not now known and such revisions could increase or decrease our depreciation expense related to properties we own, result in the classification of our leases as other than operating leases or decrease the carrying values of our assets.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

### Trends and Uncertainties

#### Real Estate Operations

The portfolio remained 90% leased at March 31, 2004. No major leases expired during the first quarter of 2004, and no new large leases were signed. During the quarter, we continued to see an increase in leasing activity and downward pressure on rental rates in most of our office markets. We cannot predict if these trends will continue, or if the increase in leasing activity will lead to an increase in our portfolio's occupancy or its rents.

Our three Houston-area apartment properties continue to face weakened demand for apartment units in the face of historic high levels of new construction. The imbalance between demand and supply is expected to continue throughout 2004, although an increase in mortgage interest rates could help to increase the supply of renters versus homebuyers.

A partial lease termination was signed in February for the release of approximately 31,000 square feet, which was not scheduled to expire in 2004, in exchange for a cash payment by the tenant of \$1,223,000.

In August 2003 we increased our line of credit which allows us to increase the

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number and size of assets held for syndication. In the first quarter of 2004 we were able to utilize this increased line and we acquired a property, Eldridge Green, prior to the completion of the syndication of Blue Lagoon Drive.

The following table summarizes property wholly owned by us as of the dates indicated:

	March 31,	
	2004	2003
Residential:		
Number of properties	4	3
Number of apartment units	837	558
Commercial:		
Number of properties	24	13
Square footage	3,049,357	1,433,000

### Investment Banking/Investment Services

Unlike our real estate operations business, which provides a rental revenue stream which is ongoing and recurring in nature, our investment banking/investment services business is transactional in nature. Both the number of Sponsored REIT syndications completed and the amount of equity raised in 2003 were below our expectations. Syndication business in the first quarter of 2004 was also slightly below already reduced expectations. Future business in this area is unpredictable.

Our property acquisition executives continue to be concerned about high valuation levels for prime commercial investment real estate in 2004. It appears that a combination of factors, including relatively low interest rates, a recovering general economy and increased capital allocation to real estate assets are increasing prices on many properties we would have an interest in acquiring. This general price increase is causing capitalization rates to fall and prices per square foot to rise. Specifically, our acquisition executives fear that we will not be able to purchase enough property during 2004 at a price acceptable under our investment criteria to grow our overall investment banking/investment services business. In the first quarter of 2004 investment demand by our client base exceeded our ability to acquire acceptable properties. If this situation continues into future quarters, lower revenues from this business could reduce the cash available for distribution to stockholders as dividends. However, the same capital market forces that are causing higher real estate prices and difficulties in achieving property acquisition goals are also presenting some appealing opportunities for the dispositions of certain of our assets. Although our general intention is to hold our properties for long-term appreciation, if opportunities present themselves that are sufficiently attractive, we may take advantage of the current market environment in 2004 and sell certain selected real estate assets. The sale of these assets could generate cash gains available for distribution to shareholders as dividends.

We continue to rely solely on our in-house investment executives to access interested investors who have capital they can afford to place in an illiquid position for an indefinite period of time (i.e., invest in a Sponsored REIT). While we continue to expand our in-house sales force, uncertainties always exist as to whether we are capable, either through our existing client base or through new clients, of raising the amount of capital invested in Sponsored REITs to achieve future performance objectives.

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### Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

#### Results of Operations

The following table shows the variance in dollars for our operations for the three months ended March 31, 2004 and 2003.

(in thousands)	Variance in dollars for the three months ended March 31, 2004 and 2003 -----
<b>Revenue:</b>	
<b>Rental Operations</b>	
Rental Income	\$ 12,646
Transaction Income	(213)
Sponsored REIT income	1,285
Other Income	33
	-----
Total rental operations revenue	13,751
<b>Investment banking/investment services</b>	
Syndication Income	(192)
Transaction Income	547
	-----
Total investment banking/investment services revenue	355
<b>Total Revenue</b>	<b>14,106</b>
<b>Expenses:</b>	
<b>Rental operations</b>	
Selling, general and administrative	115
Rental operating expenses	1,866
Depreciation and amortization	2,376
Real estate taxes and insurance	1,623
Sponsored REIT expense	752
Interest Expense	(67)
	-----
Total rental operations expenses	6,665
<b>Investment banking/investment Services Expenses</b>	
Selling, general and administrative	13
Commission expense	(96)
Shares issued as compensation	162
Depreciation and amortization	(6)
	-----
Total investment banking/investment services expenses	73
<b>Total Expenses</b>	<b>6,738</b>
<b>Income before interest income and taxes on income</b>	<b>7,368</b>
<b>Interest income</b>	<b>178</b>
	-----
<b>Income before taxes on income</b>	<b>7,546</b>
<b>Taxes on income</b>	<b>(99)</b>
	-----
<b>Income before discontinued operations</b>	<b>7,447</b>

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Income from discontinued operations	(95)
Gain on sale of real estate from discontinued ops	(1,421)
	-----
Net Income	\$ 5,931
	=====

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### Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

Comparison of the three months ended March 31, 2004 to the three months ended March 31, 2003.

On June 1, 2003, we completed the acquisition by merger of 13 Sponsored REITs, which more than doubled the size of our real estate operations. Increases in rental revenues and expenses in the three months ended March 31, 2004 as compared to the three months ended March 31, 2003 are primarily a result of this merger. We also sold two properties in 2003. The results of operations for these two properties are shown as discontinued operations. The result of operations for the three months ended March 31, 2003 has been adjusted to reflect the sale of the two properties in 2003.

Our investment banking/investment services segment completed the syndication of two Sponsored REITs with total gross proceeds of \$49.2 million in the three months ended March 31, 2004; a decrease of \$3.7 million compared to two Sponsored REITs syndicated in the three months ended March 31, 2003 with gross proceeds of \$52.9 million. Revenues and expenses for investment banking and/or investment services are directly related to the gross proceeds of these syndications.

#### Net Income

Our net income for the three months ended March 31, 2004 was \$13.2 million, compared to \$7.3 million for the comparable period in 2003, an increase of approximately \$5.9 million.

#### Revenue

Total revenues increased \$14.1 million, or 112%, to \$26.6 million for the three months ended March 31, 2004, as compared to \$12.5 million for the comparable period in 2003.

Revenue from real estate operations was \$22.9 million for the three months ended March 31, 2004; an increase of \$13.7 million, or 150%, compared to the three months ended March 31, 2003. The increase is attributable to:

- o An increase in rental revenue of \$12.5 million, relating to the thirteen REITs acquired in 2003. This includes a lease termination fee of approximately \$1.2 million paid by a tenant.
- o An increase in Sponsored REIT income of \$1.3 million. This increase relates to our increased line of credit which allows us to acquire more than one property held for syndication at a time. During the three months ended March 31, 2004 we completed the syndication of two properties, FSP Blue Lagoon Drive Corp. and FSP Eldridge Green Corp.

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- o These increases were offset by a decrease in transaction (loan commitment) fees of \$0.2 million attributable to the reduction in gross proceeds from syndications as described above.

Investment banking/investment services revenue was \$3.7 million for the three months ended March 31, 2004; an increase of \$0.4 million, or 10%, compared to the three months ended March 31, 2003. This increase is primarily attributable to transaction fee income relating to property organization and acquisition fees being recognized when the syndication process is complete. We completed the syndication of two properties in the three months ended March 31, 2004 compared to the syndication of one property for the comparable period in 2003.

### Expenses

Total expenses during the three months ended March 31, 2004 increased \$6.7 million to \$13.3 million compared to \$6.6 million for the three months ended March 31, 2003.

Expenses from real estate operations increased \$6.6 million primarily attributable to aggregate expenses of \$5.7 million for the 13 properties acquired by us in June 2003. In addition Sponsored REIT expenses increased \$0.8 million as a result of us holding two properties for syndication during the three months ended March 31, 2004 compared to the syndication of one property for the comparable period in 2003.

Investment banking/investment services expenses increased \$0.1 million primarily as a result of us issuing shares as compensation during the three months ended March 31, 2004. We did not issue any shares as compensation in 2003.

### Taxes on income

Taxes on income were \$0.3 million for the three months ended March 31, 2004 compared to \$0.2 million for the three months ended March 31, 2003.

### Discontinued operations

We sold the Wesleyan Oaks apartment complex in February 2003 and recognized a gain of \$1.4 million. There were no sales of real estate in the comparable period of 2004.

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## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

### Liquidity and Capital Resources

Cash and cash equivalents were \$53.9 million and \$58.7 million at March 31, 2004 and December 31, 2003, respectively. This decrease of \$4.8 million is attributable to \$15.0 million provided by operating activities offset by \$0.2 million used for investing activities and \$19.6 million used for financing activities.

### Operating Activities

Our cash provided by operating activities of \$15.0 million is primarily attributable to net income of approximately \$13.2 million plus a net adjustment of \$3.4 million for non-cash activity (principally relating to depreciation of \$3.3 million). This increase was offset by a \$1.4 million net change in operating assets and liabilities and a payment of \$0.2 million of leasing

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commissions.

### Investing Activities

Our cash used for investing activities of \$0.2 million is primarily attributable to the \$4.1 million decrease in assets held for syndication offset by a \$4.3 million investment in preferred stock of FSP Blue Lagoon Drive Corp.

### Financing Activities

Our cash used for financing activities of \$19.6 million is attributable to a \$4.1 million payment for a bank note payable, \$15.3 million of distributions to shareholders and \$0.1 million purchase of treasury stock.

### Sources and Uses of Funds

Our principal demands for liquidity are cash for operations, dividends to equity holders, debt repayments and expenses associated with indebtedness. As of March 31, 2004 we had approximately \$6.8 million in liabilities. We have no permanent, long-term debt. In the near term, liquidity is generated from funds from ongoing real estate operations and transaction fees and commissions received in connection with the sale of shares in newly formed Sponsored REITs.

### Line of Credit

We maintain an unsecured line of credit through Citizens Bank. In August 2003, we amended our Master Promissory Note and Loan Agreement which now provides for a revolving line of credit of up to \$125 million. The loan agreement expires August 18, 2005. Borrowings under the loan bear interest at either the bank's base rate or a variable rate based on LIBOR. We typically use the unsecured line of credit to provide each newly formed Sponsored REIT with the funds to purchase a property. Our loan agreement with the bank includes customary restrictions on property liens and requires compliance with various financial covenants. Financial covenants include maintaining minimum cash balances in operating accounts, maintaining a minimum tangible net worth and compliance with other various debt and income ratios. We were in compliance with all covenants as of March 31, 2004. We have no borrowings under its revolving credit facility as of March 31, 2004.

### Contingencies

We are subject to various legal proceedings and claims that arise in the ordinary course of its business. Although occasional adverse decisions (or settlements) may occur, we believe that the final disposition of such matters will not have a material adverse effect on our financial position or results of operations.

### Assets Held for Syndication

As of March 31, 2004 there are no assets held for syndication. As of December 31, 2003 we had one asset held for syndication. The syndication of this asset was completed in the first quarter of 2004.

### Related Party Transactions

In the three months ended March 31, 2004, we completed the syndication of two Sponsored REITs. We retained a non-controlling common stock interest in those Sponsored REITs with virtually no economic benefit. As discussed in Note 3 to our Consolidated Financial Statements, during the first quarter of 2004, we purchased 49.25 preferred shares, or 8.22% of the preferred stock, of FSP Blue Lagoon Drive Corp. We did not enter into any other significant transactions with related parties during the quarter ended March 31, 2004. For a discussion of



transactions between us and related parties during 2003, see Footnote No. 5 "Related Party Transactions" to the Consolidated Financial Statements of the Company's Annual Report on Form 10-K for the year ended December 31, 2003.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

#### Economic Conditions

We generally pay the ordinary annual operating expenses of our properties from the rental revenue generated by the properties. For the three months ended March 31, 2004, the rental income exceeded the expenses for each individual property, with the exception of Blue Ravine. The single tenant lease at the Blue Ravine property located in Folsom, California, expired June 30, 2003; there is no new lease, and we expect that the property will not produce revenue to cover its expenses in the second quarter. In addition to rental income we maintain cash reserves that may be used to fund unusual expenses or major capital improvements.

The cash reserves included in cash and cash equivalents, which as of March 31, 2004 were approximately \$15 million, are in excess of the known needs for extraordinary expenses or capital improvements for the real properties currently owned by us within the next year. There are no external restrictions on these reserves, and they may be used for any business purpose.

Although there is no guarantee that we will be able to obtain the funds necessary for our future growth, we anticipate generating funds from continuing real estate operations and from fees and commissions from the sale of shares in newly formed Sponsored REITs. We believe that we have adequate funds to cover unusual expenses and capital improvements, in addition to normal operating expenses. Our ability to maintain or increase our level of dividends to stockholders, however, depends in part upon the level of interest on the part of investors in purchasing shares of Sponsored REITs and the level of rental income from our real properties.

#### CERTAIN FACTORS THAT MAY AFFECT FUTURE RESULTS

The following important factors, among others, could cause actual results to differ materially from those indicated by forward-looking statements made in this Annual Report on Form 10-K and presented elsewhere by management from time to time.

If we are not able to collect sufficient rents from each of our owned real properties, we may suffer significant operating losses.

A substantial portion of our revenues are generated by the rental income of our real properties. If our properties do not provide us with a steady rental income, our revenues will decrease and may cause us to incur operating losses in the future.

We face risks in continuing to attract investors for Sponsored REITs.

Our investment banking/investment services business continues to depend upon its ability to attract purchasers of equity interests in Sponsored REITs. Our success in this area will depend on the propensity and ability of investors who have previously invested in Sponsored REITs to continue to invest in future Sponsored REITs and on our ability to expand the investor pool for the Sponsored REITs by identifying new potential investors. Moreover, our investment

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banking/investment services business may be affected to the extent existing Sponsored REITs incur losses or have operating results that fail to meet investors' expectations.

If we are unable to fully syndicate a Sponsored REIT, we may be required to keep a balance outstanding on our line of credit or use our cash balance to repay our line of credit, which may reduce cash available for distribution to our stockholders.

We typically draw on our line of credit to make an interim mortgage loan to a Sponsored REIT, so that it can acquire real property prior to the consummation of the offering of its equity interests; this interim loan is secured by a first mortgage of the real property acquired by the Sponsored REIT. Once the offering has been completed, the Sponsored REIT repays the loan out of the offering proceeds. If we are unable to fully syndicate a Sponsored REIT, the Sponsored REIT could be unable to fully repay the loan, and we would have to satisfy our obligation under our line of credit through other means. If we are required to use cash for this purpose, we would have less cash available for distribution to our stockholders.

We may not be able to find properties that meet our criteria for purchase.

Growth in our investment banking/investment services business is dependent on the ability of our acquisition executives to find properties for sale which meet our investment criteria. To the extent they fail to find such properties, we will be unable to syndicate offerings of Sponsored REITs to investors, and this segment of our business could have lower revenue, which would reduce the cash available for distribution to our stockholders.

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### Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

We are dependent on key personnel.

We depend on the efforts of George Carter, our Chief Executive Officer, and our other executive officers. If they were to resign, our operations could be adversely affected. We do not have employment agreements with Mr. Carter or any other of our executive officers.

Our level of dividends may fluctuate.

Because our investment banking/investment services business is transactional in nature and real estate occupancy levels and rental rates can fluctuate, there is no predictable recurring level of revenue from such activities. As a result of this, the amount of cash available for distribution may fluctuate, which may result in us not being able to maintain or grow dividend levels in the future.

The real properties held by us may significantly decrease in value.

As of March 31, 2004, we owned 28 properties. Some or all of these properties may decline in value. To the extent our real properties decline in value, our stockholders could lose some or all the value of their investments.

New acquisitions may fail to perform as expected.

We may acquire new properties, whether by cash purchase, by acquisition of Sponsored REITs or by investment in a Sponsored REIT. Newly acquired properties may fail to perform as expected, in which case, our results of operations could

be adversely affected.

We face risks in owning and operating real property.

An investment in us is subject to the risks incident to the ownership and operation of real estate-related assets. These risks include the fact that real estate investments are generally illiquid, which may impact our ability to vary our portfolio in response to changes in economic and other conditions, as well as the risks normally associated with:

- o changes in general and local economic conditions;
- o the supply or demand for particular types of properties in particular markets;
- o changes in market rental rates; o the impact of environmental protection laws; and
- o changes in tax, real estate and zoning laws.

Certain significant costs, such as real estate taxes, utilities, insurance and maintenance costs, generally are not reduced even when a property's rental income is reduced. In addition, environmental and tax laws, interest rate levels, the availability of financing and other factors may affect real estate values and property income. Furthermore, the supply of commercial and multi-family residential space fluctuates with market conditions.

We face risks from tenant defaults or bankruptcies.

If any of our tenants defaults on its lease, we may experience delays in enforcing our rights as a landlord and may incur substantial costs in protecting our investment. In addition, at any time, a tenant of one of our properties may seek the protection of bankruptcy laws, which could result in the rejection and termination of such tenant's lease and thereby cause a reduction in cash available for distribution to our stockholders.

We may encounter significant delays in reletting vacant space, resulting in losses of income.

When leases expire, we will incur expenses and may not be able to re-lease the space on the same terms. Certain leases provide tenants the right to terminate early if they pay a fee. If we are unable to re-lease space promptly, if the terms are significantly less favorable than anticipated or if the costs are higher, we may have to reduce distributions to our stockholders.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

We face risks from geographic concentration.

The properties in our portfolio, by aggregate square footage, are distributed geographically as follows: Southwest - 26%, Northeast - 31%, Midwest - 19%, West - 16% and Southeast 8%. However, within certain of those segments, we hold a larger concentration of our properties in Houston, Texas - 18% and Washington, DC - 13%. We are likely to face risks to the extent that any of these areas in which we hold a larger concentration of our properties suffer deteriorating economic conditions.

We compete with national, regional and local real estate operators and developers, which could adversely affect our cash flow.

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Competition exists in every market in which our properties are located and in every market in which our properties will be located. We compete with, among others, national, regional and numerous local real estate operators and developers. Such competition may adversely affect the percentage of leased space and the rental revenues of our properties, which could adversely affect our cash flow from operations and our ability to make expected distributions to our stockholders. Some of our competitors may have more resources than we do or other competitive advantages. Competition may be accelerated by any increase in availability of funds for investment in real estate. For example, decreases in interest rates tend to increase the availability of funds and therefore can increase competition. To the extent that our properties continue to operate profitably, this will likely stimulate new development of competing properties. The extent to which we are affected by competition will depend in significant part on local market conditions.

There is limited potential for an increase in leased space gains in our properties.

We anticipate that future increases in revenue from our properties will be primarily the result of scheduled rental rate increases or rental rate increases as leases expire. Properties with higher rates of vacancy are generally located in soft economic markets so that it may be difficult to realize increases in revenue when vacant space is re-leased.

We are subject to possible liability relating to environmental matters, and we cannot assure you that we have identified all possible liabilities.

Under various federal, state and local laws, ordinances and regulations, an owner or operator of real property may become liable for the costs of removal or remediation of certain hazardous substances released on or in its property. Such laws may impose liability without regard to whether the owner or operator knew of, or caused, the release of such hazardous substances. The presence of hazardous substances on a property may adversely affect the owner's ability to sell such property or to borrow using such property as collateral, and it may cause the owner of the property to incur substantial remediation costs. In addition to claims for cleanup costs, the presence of hazardous substances on a property could result in the owner incurring substantial liabilities as a result of a claim by a private party for personal injury or a claim by an adjacent property owner for property damage.

In addition, we cannot assure you that:

- o future laws, ordinances or regulations will not impose any material environmental liability;
- o the current environmental conditions of our properties will not be affected by the condition of properties in the vicinity of such properties (such as the presence of leaking underground storage tanks) or by third parties unrelated to us;
- o tenants will not violate their leases by introducing hazardous or toxic substances into our properties that could expose us to liability under federal or state environmental laws; or
- o environmental conditions, such as the growth of bacteria and toxic mold in heating and ventilation systems or on walls, will not occur at our properties and pose a threat to human health.

We are subject to compliance with the Americans With Disabilities Act and fire and safety regulations which could require us to make significant capital expenditures.

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All of our properties are required to comply with the Americans With Disabilities Act (ADA), and the regulations, rules and orders that may be issued thereunder. The ADA has separate compliance requirements for "public accommodations" and "commercial facilities," but generally requires that buildings be made accessible to persons with disabilities. Compliance with ADA requirements might require, among other things, removal of access barriers and noncompliance could result in the imposition of fines by the U.S. government, or an award of damages to private litigants.

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### Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

In addition, we are required to operate our properties in compliance with fire and safety regulations, building codes and other land use regulations, as they may be adopted by governmental agencies and bodies and become applicable to our properties. Compliance with such requirements may require us to make substantial capital expenditures, which expenditures would reduce cash otherwise available for distribution to its stockholders.

There are significant conditions to our obligation to redeem shares of our common stock, and any such redemption will result in the stockholders tendering shares receiving less than their fair market value.

Under our redemption plan, we are only obligated to use our best efforts to redeem shares of our common stock from stockholders wishing to have them redeemed. There are significant conditions to our obligation to redeem shares of our common stock including:

- o we cannot be insolvent or be rendered insolvent by the redemption;
- o the redemption cannot impair our capital or operations;
- o the redemption cannot contravene any provision of federal or state securities laws;
- o the redemption cannot result in our failing to qualify as a REIT;
- and
- o our management must determine that the redemption is in our best interests.

Any redemption effected by us under this plan would result in those stockholders tendering shares of our common stock receiving 90% of the fair market value of such shares, as determined by our board of directors in its sole and absolute discretion, and not their full fair market value.

We may lose capital investment or anticipated profits if an uninsured event occurs.

We carry or our tenants carry comprehensive liability, fire and extended coverage with respect to each of our properties, with policy specification and insured limits customarily carried for similar properties. There are, however, certain types of losses, such as from wars, pollution or earthquakes, that may be either uninsurable or not economically insurable (although the properties located in California all have earthquake insurance). Should an uninsured material loss occur, we could lose both capital invested in the property and anticipated profits.

Contingent or unknown liabilities acquired in mergers or similar transactions could require us to make substantial payments.

The properties which we acquired in mergers were acquired subject to liabilities

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and without any recourse with respect to liabilities, whether known or unknown. As a result, if liabilities were asserted against us based upon any of these properties, we might have to pay substantial sums to settle them, which could adversely affect our results of operations and financial condition and our cash flow and ability to make distributions to our stockholders. Unknown liabilities with respect to properties acquired might include:

- o liabilities for clean-up or remediation of environmental conditions;
- o claims of tenants, vendors or other persons dealing with the former owners of the properties; and
- o liabilities incurred in the ordinary course of business.

We would incur adverse tax consequences if we failed to qualify as a REIT.

If in any taxable year we do not qualify as a real estate investment trust, we would be taxed as a corporation and distributions to our stockholders would not be deductible by us in computing our taxable income. In addition, if we were to fail to qualify as a real estate investment trust, we could be disqualified from treatment as a real estate investment trust in the year in which such failure occurred and for the next four taxable years and, consequently, we would be taxed as a corporation during such years. Failure to qualify for even one taxable year could result in a significant reduction of our cash available for distribution to stockholders or could require us to incur indebtedness or liquidate investments in order to generate sufficient funds to pay the resulting federal income tax liabilities. In addition, timing differences between the receipt of income and payment of expenses and the inclusion and deduction of such amounts in arriving at taxable income could make it necessary for us to borrow in order to make certain distributions to our stockholders in satisfaction of the 90% distribution requirement applicable to real estate investment trusts. The provisions of the Internal Revenue Code governing the taxation of real estate investment trusts are very technical and complex, and although we expect that we will be organized and will operate in a manner that will enable us to meet such requirements, no assurance can be given that we will always succeed in doing so. In addition, you should note that if one or more of the REITs we acquired in June 2003 did not qualify as a real estate

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### Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

investment trust immediately prior to the consummation of the mergers, we would be disqualified as a REIT as a result of the mergers.

As a result of our acquisition of 13 REITs, we may no longer qualify as a REIT.

As a result of our acquisition of 13 REITs by merger in June 2003, we might no longer qualify as a real estate investment trust under Section 856 of the Internal Revenue Code of 1986, as amended. We could lose our ability to so qualify for a variety of reasons relating to the nature of the assets acquired from the acquired REITs, the identity of the shareholders of the acquired REITs who became our shareholders, or the failure of one or more of the acquired REITs to have previously qualified as a real estate investment trust.

Provisions in our organizational documents may prevent changes in control.

Our Articles of Incorporation and Bylaws contain provisions, described below, which may have the effect of discouraging a third party from making an acquisition proposal for us and may thereby inhibit a change of control under circumstances that could otherwise give the holders of our common stock the

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opportunity to realize a premium over the then-prevailing market prices.

**Ownership Limits.** In order for us to maintain our qualification as a real estate investment trust, the holders of our common stock may be limited to owning, either directly or under applicable attribution rules of the Internal Revenue Code, no more than 9.8% of the lesser of the value or the number of equity shares of us, and no holder of common stock may acquire or transfer shares that would result in our shares of common stock being beneficially owned by fewer than 100 persons. Such ownership limit may have the effect of preventing an acquisition of control of us without the approval of our board of directors. Moreover, we will have the right to redeem any shares of common stock that are acquired or transferred in violation of these provisions at the market price, which is determined by our board of directors. In addition, our Articles of Incorporation give our board of directors the right to refuse to give effect to the acquisition or transfer of shares by a stockholder in violation of these provisions.

**Staggered Board.** Our board of directors is divided into three classes. The terms of these classes will expire in 2004, 2005 and 2006, respectively. Directors of each class are elected for a three-year term upon the expiration of the initial term of each class. The staggered terms for directors may affect our stockholders' ability to effect a change in control even if a change in control were in the stockholders' best interests.

**Preferred Stock.** Our Articles of Incorporation authorize our board of directors to issue up to 20,000,000 shares of preferred stock, par value \$.0001 per share, and to establish the preferences and rights of any such shares issued. The issuance of preferred stock could have the effect of delaying or preventing a change in control even if a change in control were in our stockholders' best interest.

**Increase of Authorized Stock.** Our board of directors, without any vote or consent of the stockholders, may increase the number of authorized shares of any class or series of stock or the aggregate number of authorized shares we have authority to issue. The ability to increase the number of authorized shares and issue such shares could have the effect of delaying or preventing a change in control even if a change in control were in our stockholders' best interest.

**Amendment of Bylaws.** Our board of directors has the sole power to amend our Bylaws. This power could have the effect of delaying or preventing a change in control even if a change in control were in our stockholders' best interests.

**Stockholder Meetings.** Our Bylaws require advance notice for stockholder proposals to be considered at annual meetings of stockholders and for stockholder nominations for election of directors at special meetings of stockholders. Our Bylaws also provide that stockholders entitled to cast more than 50% of all the votes entitled to be cast at a meeting must join in a request by stockholders to call a special meeting of stockholders. These provisions could have the effect of delaying or preventing a change in control even if a change in control were in the best interests of our stockholders.

**Supermajority Votes Required.** Our Articles of Incorporation require the affirmative vote of the holders of no less than 80% of the shares of capital stock outstanding and entitled to vote in order (i) to amend the provisions of our Articles of Incorporation relating to the classification of directors, removal of directors, limitation of liability of officers and directors or indemnification of officers and directors or (ii) to amend our Articles of Incorporation to impose cumulative voting in the election of directors. These provisions could have the effect of delaying or preventing a change in control even if a change in control were in our stockholders' best interest.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

There is no public trading market for our securities.

There is no public trading market for our common stock, and we cannot assure you that any market will develop or that, if such a market develops, there will be any liquidity in such a market for our common stock.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

We were not a party to any derivative financial instruments at or during the three months ended March 31, 2004.

We borrow from time to time on our line of credit. These borrowings bear interest at a variable rate. As of March 31, 2004, \$0 was outstanding under this line of credit. We have used the funds from our line of credit for the purpose of making interim mortgage loans to Sponsored REITs. These mortgage loans bear interest at the same variable rate payable by us under our line of credit. Therefore, we believe that we have mitigated our interest rate risk with respect to our borrowings.

Item 4. Controls and Procedures.

Our management, with the participation of FSP Corp.'s President and Chief Executive Officer and FSP Corp.'s Vice President and Chief Operating Officer (equivalent of Chief Financial Officer), evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(d) under the Exchange Act) as of December 31, 2003. Based on this evaluation, FSP Corp.'s President and Chief Executive Officer and FSP Corp.'s Vice President and Chief Operating Officer (equivalent of Chief Financial Officer) concluded that, as of March 31, 2004, our disclosure controls and procedures were (1) designed to ensure that material information relating to us, including our consolidated subsidiaries, is made known to FSP Corp.'s President and Chief Executive Officer and FSP Corp.'s Vice President and Chief Operating Officer (equivalent of Chief Financial Officer) by others within these entities, particularly during the period in which this report was being prepared and (2) effective, in that they provide reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

No change to our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the quarter ended March 31, 2004 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings:

Not applicable.

Item 2. Changes in Securities, Use of Proceeds and Issuer Purchases of Equity



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### Securities:

(e) The following table provides information about purchases by the company during the quarter ended March 31, 2004 of equity securities that are registered by the company pursuant to Section 12 of the Exchange Act:

#### ISSUER PURCHASES OF EQUITY SECURITIES

Period	(a) Total Number of Shares (or Units) Purchased (1)	(b) Average Price Paid per Share (or Unit)	(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs (1)	(d) Maximum Approximate Number of Shares that May Yet Be Purchased Under the Programs
01/01/04-01/31/04	9,823.46	\$14.80	0	
02/01/04-02/29/04	0	N/A	0	
03/01/04-03/31/04	0	N/A	0	
<b>Total:</b>	<b>9,823.46</b>	<b>\$14.80</b>	<b>0</b>	

(1) FSP Corp. does not have any publicly announced repurchase plans or programs. However, FSP Corp.'s Articles of Incorporation provide that FSP Corp. will use its best efforts to redeem shares of its common stock from stockholders who request such redemption. Any FSP Corp. stockholder wishing to have shares redeemed must make such a request no later than July 1 of any year for a redemption that would be effective the following January 1.

This obligation is subject to significant conditions, including that (i) FSP Corp. cannot be insolvent or rendered insolvent by the redemption, (ii) the redemption cannot impair the capital or operations of FSP Corp., (iii) the redemption cannot contravene any provision of federal or state securities law, (iv) the redemption cannot result in FSP Corp.'s failing to qualify as a REIT, and (v) the management of FSP Corp. must determine that the redemption is in the best interest of FSP Corp. Redemptions pursuant to these provisions result in redeeming stockholders receiving cash in an amount of 90% of the fair market value of the stock redeemed, as determined by FSP Corp.'s Board of Directors.

#### Item 3. Defaults Upon Senior Securities:

Not applicable.

#### Item 4. Submission of Matters to a Vote of Security Holders:

#### Item 5. Other Information:

Not applicable.

PART II - OTHER INFORMATION (continued)

Item 6. Exhibits:

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

31.2 Certification of the Vice President, Chief Operating Officer (equivalent of Chief Financial Officer), Treasurer and Secretary of the Registrant pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

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

32.2 Certification of the Vice President, Chief Operating Officer (equivalent of Chief Financial Officer), Treasurer and Secretary of the Registrant pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Reports on Form 8-K:

On February 6, 2004, we furnished a Current Report on Form 8-K, reporting under Item 9, Regulation FD Disclosure, on the declaration of a cash dividend.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Amendment No. 1 to its Quarterly Report on Form 10-Q/A to be signed on its behalf as of July 29, 2004 by the undersigned, thereunto duly authorized.

FRANKLIN STREET PROPERTIES CORP.

By: /s/ Barbara J. Corinha

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Barbara J. Corinha  
Vice President, Chief Operating Officer,  
Treasurer and Secretary

EXHIBIT INDEX

Exhibit No.	Description
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31.1	Certification of FSP Corp.'s President and Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (as amended and restated).
31.2	Certification of FSP Corp.'s Vice President, Chief Operating

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Officer (equivalent of Chief Financial Officer), Treasurer and Secretary pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (as amended and restated).

31.3 Certification of FSP Corp.'s President and Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.4 Certification of FSP Corp.'s Vice President, Chief Operating Officer (equivalent of Chief Financial Officer), Treasurer and Secretary pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.