CEDAR REALTY TRUST, INC.
Form 424B5
January 07, 2015
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Registration No. 333-179956

PROSPECTUS SUPPLEMENT

(To prospectus dated May 2, 2012)

CEDAR REALTY TRUST, INC.

5,000,000 Shares of Common Stock

We are offering 5,000,000 shares of our common stock, par value $0.06 per share.

Our common stock is listed on the New York Stock Exchange, or the NYSE, under the symbol CDR. On January 6, 2015, the last reported sales price of our common stock on the NYSE was $7.64 per share.

There are restrictions on ownership of our common stock intended, among other purposes, to preserve our qualification as a real estate investment trust, or REIT. See Description of Common Stock Restrictions on Ownership in the accompanying prospectus.

Investing in our common stock involves risks that are described in the Risk Factors sections beginning on page S-3 of this prospectus supplement, page 3 of the accompanying prospectus and page 13 of our Annual Report on Form 10-K for the year ended December 31, 2013.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus supplement or the accompanying prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The underwriter has agreed to purchase our common stock from us at a price of $7.30 per share, which will result in approximately $36.5 million of proceeds to us, before expenses. The underwriter may offer our common stock in transactions on the NYSE, in the over-the-counter market or through negotiated transactions at market prices or at negotiated prices. See Underwriting.

We have granted the underwriter an option to purchase up to 750,000 additional shares of common stock from us within 30 days after the date of this prospectus supplement.

The underwriter expects to deliver the shares of our common stock to purchasers on or about January 12, 2015 through the book-entry facilities of The Depository Trust Company.

Raymond James

The date of this prospectus supplement is January 6, 2015.

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Prospectus Supplement

Prospectus

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In this prospectus supplement, the terms Company, we, us and our include Cedar Realty Trust, Inc. and its consolidated subsidiaries, including Cedar Realty Trust Partnership, L.P., or our operating partnership.

You should rely only on the information contained or incorporated by reference in this prospectus supplement, the accompanying prospectus and any free writing prospectus prepared by us. We have not, and the underwriter has not, authorized any person to provide you with different information. If anyone provides you with different or inconsistent information, you should not rely on it. We are not, and the underwriter is not, making an offer to sell these securities in any jurisdiction where the offer or sale is not permitted. You should assume that the information appearing in this prospectus supplement, the accompanying prospectus and any free writing prospectus prepared by us, as well as the documents incorporated by reference, is accurate only as of their respective dates or on other dates which are specified in those documents. Our business, financial condition, results of operations and prospects may have changed since those dates.

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PROSPECTUS SUPPLEMENT SUMMARY

This summary may not contain all of the information that is important to you. You should carefully read this entire prospectus supplement and the accompanying prospectus, including the sections entitled Risk Factors beginning on page S-3 of this prospectus supplement and page 3 of the accompanying prospectus, as well as the information appearing under the caption Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2013, before making a decision to invest in our common stock. You should also read the documents we have referred you to in Incorporation of Certain Information by Reference. This summary is qualified in its entirety by the more detailed information and financial statements, including the notes thereto, appearing elsewhere or incorporated by reference in this prospectus supplement and the accompanying prospectus.

The Company

We are a fully-integrated real estate investment trust that focuses primarily on ownership and operation of grocery-anchored shopping centers straddling the Washington D.C. to Boston corridor. At September 30, 2014, we owned and managed a portfolio of 58 operating properties (excluding properties held for sale/conveyance) totaling approximately 9.2 million square feet of gross leasable area, or GLA. We conduct our business and own all of our properties through our operating partnership, in which we owned at September 30, 2014 an approximate 99.5% economic interest, and are its sole general partner. Our principal executive offices are located at 44 South Bayles Avenue, Port Washington, NY 11050, our telephone number is (516) 767-6492 and our website address is www.cedarrealtytrust.com. The contents of our website are not a part of this prospectus supplement or the accompanying prospectus.

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The Offering

The following is a brief summary of certain terms of this offering. For a more complete description of the terms of our common stock, see Description of Common Stock in the accompanying prospectus.

Issuer	Cedar Realty Trust, Inc.
Shares of Common Stock Offered by Us	5,000,000 shares of common stock, par value $0.06 per share (5,750,000 shares if the underwriter s option to purchase additional shares is exercised in full)
Shares of Common Stock to be Outstanding After This Offering	84,225,083 shares (84,975,083 shares if the underwriter s option to purchase additional shares is exercised in full)
Shares of Common Stock and Operating Partnership Units to be Outstanding After This Offering	84,618,238 shares/operating partnership units (85,368,238 shares/operating partnership units if the underwriter s option to purchase additional shares is exercised in full)
Use of Proceeds	We will contribute the net proceeds from this offering to our operating partnership. Our operating partnership presently intends to use all the net proceeds from this offering for general working capital and other corporate purposes, including the repayment of outstanding indebtedness and the acquisition of additional properties. Pending such use, the net proceeds will be used to temporarily repay amounts outstanding under our revolving credit facility. See Use of Proceeds.
Restrictions on Ownership	To assist us in complying with certain federal income tax requirements applicable to REITs, our charter and bylaws contain certain restrictions relating to the ownership and transfer of our common stock, including an ownership limit of 9.9% of our total outstanding common stock. See Description of Common Stock Restrictions on Ownership in the accompanying prospectus.
Risk Factors	See Risk Factors beginning on page S-3 of this prospectus supplement, on page 3 of the accompanying prospectus and on page 13 of our Annual Report on Form 10-K for the year ended December 31, 2013, for risks you should consider before purchasing shares of our common stock.
NYSE Symbol	CDR

The number of shares of common stock to be outstanding after this offering is based on 79,225,083 shares outstanding as of January 5, 2015, including 3,180,723 treasury shares. The number of outstanding operating partnership units held by parties other than us after this offering is based on 393,155 units outstanding as of January 5, 2015. Subject to the limitations in our operating partnership s partnership agreement, the operating partnership units are exchangeable for shares of our common stock on a one-to-one basis.

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RISK FACTORS

An investment in our common stock involves a number of risks. Before making an investment decision to purchase our common stock, you should carefully consider all of the risks described in this prospectus supplement, the risks described under Risk Factors beginning on page 3 of the accompanying prospectus and on page 13 of our Annual Report on Form 10-K for the year ended December 31, 2013, as well as the other information contained in, or incorporated by reference into, this prospectus supplement and the accompanying prospectus. If any of these risks actually occurs, our business, financial condition and results of operations could be materially adversely affected. If this were to occur, the value of our common stock could decline significantly and you may lose all or part of your investment.

The market price of our shares of common stock may fluctuate or decline significantly.

The market price of our shares of common stock may fluctuate or decline significantly in response to many factors, including those described under Forward-Looking Statements in this prospectus supplement, as well as:

- actual or anticipated changes in operating results or business prospects;
- changes in earnings estimates by securities analysts;
- an inability to meet or exceed securities analysts estimates or expectations;
- difficulties or inability to access capital or extend or refinance existing debt;
- decreasing (or uncertainty in) real estate valuations;
- publication of research reports about us or the real estate industry;
- changes in analyst ratings or our credit ratings;
- conditions or trends in our industry or sector;
- the performance of our competitors and related market valuations;
- announcements by us or our competitors of significant acquisitions, strategic partnerships, divestitures, joint ventures or other strategic initiatives;

- changes in interest rates;
- additions or departures of key personnel;
- future sales of our common stock or securities convertible into, or exchangeable or exercisable for, our common stock;
- the realization of any of the other risk factors included or incorporated by reference in this prospectus supplement and the accompanying prospectus; and
- general market and economic conditions.

You may experience significant dilution as a result of this offering and additional issuances of our securities, which could harm the market price of our common stock.

Our board of directors is authorized, without shareholder approval, to issue additional common or preferred stock or securities convertible into or exchangeable for equity securities. We may, from time to time and at any time, seek to offer and sell common or preferred stock or other securities based on market conditions and other factors that may be beyond our control.

This offering may have a dilutive effect on our earnings per share and funds from operations per share. The actual amount of dilution from this offering, or from any future offering of common or preferred stock, will be

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based on numerous factors, particularly the use of proceeds and the return expected to be generated by such investment, and cannot be determined at this time. The market price of our common stock could decline as a result of sales of a large number of shares of our common stock in the market pursuant to this offering or otherwise, as a result of the perception or expectation that such sales could occur.

Holders of our debt or preferred stock have liquidation and other rights that are senior to the rights of the holders of our common stock. Any future issuance of debt or preferred stock could adversely affect the market price of our common stock.

As of September 30, 2014, we had approximately $686.2 million of debt outstanding and approximately 7.95 million shares of Series B Preferred Stock were issued and outstanding. Holders of our debt and preferred stock have liquidation rights and other rights that are senior to the rights of holders of our common stock. Upon any voluntary or involuntary liquidation, dissolution or winding up, payment will be made to holders of our debt and preferred stock before any payment is made to the holders of our common stock. This will reduce the amount of our assets, if any, available for distribution to holders of our common stock. The decision to issue debt and preferred stock is dependent on market conditions and other factors that may be beyond our control. As a result, we cannot predict or estimate the amount, timing or nature of our future issuances. Any such future issuance could reduce the market price of our common stock.

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FORWARD-LOOKING STATEMENTS

This prospectus supplement and the accompanying prospectus contain or incorporate by reference forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act. Such forward-looking statements include, without limitation, statements containing the words anticipates , believes , expects , intends , futu and words of similar import which express our beliefs, expectations or intentions regarding future performance or future events or trends. While forward-looking statements reflect good faith beliefs, expectations or intentions, they are not guarantees of future performance and involve known and unknown risks, uncertainties and other factors, which may cause actual results, performance or achievements to differ materially from anticipated future results, performance or achievements expressed or implied by such forward-looking statements as a result of factors outside of our control. Certain factors that might cause such differences include, but are not limited to, the following: real estate investment considerations, such as the effect of economic and other conditions in general and in our market areas in particular; the financial viability of our tenants (including an inability to pay rent, filing for bankruptcy protection, closing stores and/or vacating the premises); the continuing availability of acquisition, ground up development and redevelopment opportunities on favorable terms; the availability of equity and debt capital (including the availability of construction financing) in the public and private markets; the availability of suitable joint venture partners and potential purchasers of our properties if offered for sale; the adequacy of impairment provisions for properties treated as held for sale/conveyance; changes in interest rates; the fact that returns from acquisition, ground up development and redevelopment activities may not be at expected levels or at expected times; risks inherent in ongoing ground up development and redevelopment projects including, but not limited to, cost overruns resulting from weather delays, changes in the nature and scope of ground up development and redevelopment efforts, changes in governmental regulations relating thereto, and market factors involved in the pricing of material and labor; the need to renew leases or relet space upon the expiration or termination of current leases and incur applicable required replacement costs; and the financial flexibility of us and our joint venture partners to repay or refinance debt obligations when due and to fund tenant improvements and capital expenditures. For a discussion of these and other factors that could cause actual results to differ from those contemplated in the forward-looking statements in this prospectus supplement, the accompanying prospectus and in documents incorporated by reference in this prospectus supplement and the accompanying prospectus, see the section entitled Risk Factors in this prospectus supplement and the accompanying prospectus and in documents incorporated by reference into this prospectus supplement and the accompanying prospectus, including our Annual Report on Form 10-K for the year ended December 31, 2013. We do not intend, and disclaim any duty or obligation, to update or revise any forward-looking statements set forth or incorporated by reference in this prospectus supplement to reflect any change in expectations, change in information, new information, future events or other circumstances on which such information may have been based.

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USE OF PROCEEDS

We estimate that the net proceeds from this offering, after deducting the estimated expenses of this offering payable by us, will be approximately $36.4 million ($41.9 million if the underwriter exercises its option to purchase additional shares in full). We will contribute the net proceeds from this offering to our operating partnership in exchange for common limited partnership units in our operating partnership. Our operating partnership presently intends to use all the net proceeds from this offering for general working capital and other corporate purposes, including the repayment of outstanding indebtedness and the acquisition of additional properties. Pending such use, the net proceeds will be used to temporarily repay amounts outstanding under our revolving credit facility.

We have a $310 million credit facility comprised of a five-year $50 million term loan maturing in August 2018 and a three-year $260 million revolving credit facility maturing in August 2016. The revolving credit facility may be extended for two additional one-year periods at our option. At September 30, 2014, we had approximately $81 million outstanding on our revolving credit facility with a weighted-average interest rate of 2.0%. Borrowings under the revolving credit facility bear interest at a rate of LIBOR plus 175 basis points and can range from LIBOR plus 165 to 225 basis points based on our leverage ratio.

An affiliate of the underwriter is a lender under our revolving credit facility. To the extent that the net proceeds are used to repay amounts outstanding under our revolving credit facility, such lender will receive a share of the net proceeds used to repay amounts outstanding under this facility. See Underwriting Conflicts of Interest.

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MATERIAL FEDERAL INCOME TAX CONSIDERATIONS

The following summary of certain material federal income tax considerations is based on current law, is for general information only, and is not tax advice. This discussion does not purport to address all aspects of taxation that may be relevant to particular stockholders in light of their personal investment or tax circumstances, or to certain types of stockholders (including, without limitation, insurance companies, tax-exempt organizations (except as described below in Taxation of Tax-Exempt Stockholders), financial institutions and broker dealers) subject to special treatment under the federal income tax laws. In addition, this discussion (except to the extent described below in Taxation of Non-U.S. Stockholders) does not address the tax consequences applicable to stockholders that are not U.S. holders. For this purpose, a U.S. holder is a holder of the common stock that, for federal income tax purposes, is: (i) a citizen or resident of the United States; (ii) a corporation (including an entity treated as a corporation for federal income tax purposes) created or organized under the laws of the United States, any of its States or the District of Columbia; (iii) an estate whose income is subject to federal income taxation regardless of its source; or (iv) any trust if (a) a U.S. court is able to exercise primary supervision over the administration of such trust and one or more U.S. persons have the authority to control all substantial decisions of the trust or (b) it has a valid election in place to be treated as a U.S. person. If a partnership (including any entity or arrangement treated as a partnership for federal income tax purposes) holds the common stock, the federal income tax treatment of a partner in the partnership will generally depend on the status of the partner and the activities of the partnership. If you are a partner in a partnership holding the common stock, you should consult your tax advisor regarding the consequences of the purchase, ownership and disposition of the common stock by the partnership.

EACH PROSPECTIVE PURCHASER SHOULD CONSULT WITH ITS TAX ADVISOR REGARDING THE SPECIFIC TAX CONSEQUENCES OF THE PURCHASE, OWNERSHIP AND SALE OF THE COMMON STOCK AND OF THE COMPANY S ELECTION TO BE TAXED AS A REIT, INCLUDING THE FEDERAL, STATE, LOCAL, AND FOREIGN INCOME AND OTHER TAX CONSEQUENCES OF SUCH PURCHASE, OWNERSHIP, SALE AND ELECTION, AND OF POTENTIAL CHANGES IN APPLICABLE TAX LAWS, SOME OF WHICH MAY APPLY RETROACTIVELY.

Taxation of Our Company

We have elected to be taxed as a REIT under Sections 856 through 860 of the Internal Revenue Code of 1986, as amended, or the Code, commencing with the taxable year ended December 31, 1986. We believe that we have been organized and have operated in such a manner as to qualify for taxation as a REIT, and intend to continue to operate in such a manner. However, qualification and taxation as a REIT depend upon our ability to meet on a continuing basis, through actual annual operating results, asset composition, distribution levels and diversity of stock ownership, the various qualification tests and organizational requirements imposed under the Code, as discussed below. Accordingly, no assurance can be given that we have been organized and have operated, or will continue to be organized and operate, in a manner so as to remain qualified as a REIT.

The following is a general summary of the material Code provisions and the corresponding Treasury Regulations that govern the federal income tax treatment of a REIT and its stockholders. These provisions of the Code and Treasury Regulations are highly technical and complex. This summary is qualified in its entirety by the applicable Code provisions, the Treasury Regulations, and administrative and judicial interpretations thereof.

At the closing of this offering we expect to receive an opinion of Stroock & Stroock & Lavan LLP to the effect that commencing with our taxable year ended December 31, 1998, we have been operated in conformity with the requirements for qualification as a REIT under the Code, and our actual method of operation from January 1, 2015 through the date of the opinion and our proposed method of operation, as described in this prospectus supplement and the accompanying prospectus and as represented by us, will enable us to continue to so qualify through the end of our current taxable year and thereafter. It must be emphasized that the opinion of Stroock & Stroock & Lavan LLP is based on various assumptions relating to our organization and operation,

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and is conditioned upon representations and covenants made by our management regarding our organization, income, assets, distribution levels, diversity of ownership and the past, present and future conduct of our business operations, the compliance with which has not and will not be reviewed by Stroock & Stroock & Lavan LLP. In addition, our ability to qualify as a REIT depends in part upon the operating results, organizational structure and entity classification for federal income tax purposes of certain affiliated entities, and also requires that we satisfy certain asset tests, some of which depend upon the fair market values of assets directly or indirectly owned by us which may not be susceptible to a precise determination. Accordingly, while we intend to operate so that we will qualify as a REIT, given the highly complex nature of the rules governing REITs, the ongoing importance of factual determinations, and the possibility of future changes in our circumstances, no assurance can be given by Stroock & Stroock & Lavan LLP or us that we will so qualify for any particular year. The opinion is expressed as of the date issued and counsel will have no obligation to advise us or the holders of the common stock of any subsequent change in the matters stated, represented or assumed, or of any subsequent change in the applicable law. You should be aware that opinions of counsel are not binding on the Internal Revenue Service, or the IRS, or the courts, and no assurance can be given that the IRS will not challenge the conclusions set forth in such opinions or that a court would not sustain such a challenge.

Provided we qualify for taxation as a REIT, we generally will not be required to pay federal corporate income taxes on our net income that is currently distributed to our stockholders. This treatment substantially eliminates the double taxation (at the corporate and stockholder levels) that generally results from investment in a corporation. However, we will still be required to pay federal income tax as follows:

- We will be required to pay tax at regular corporate rates on any undistributed REIT taxable income, including undistributed net capital gains.

- We may be required to pay the alternative minimum tax on our items of tax preference under some circumstances.

- If we have (1) net income from the sale or other disposition of foreclosure property which is held primarily for sale to customers in the ordinary course of business or (2) other nonqualifying income from foreclosure property, we will be required to pay tax at the highest corporate rate on this income. Foreclosure property generally is defined as property we acquired through foreclosure or after a default on a loan secured by the property or a lease of the property.

- We will be required to pay a 100% tax on any net income from prohibited transactions. Prohibited transactions are, in general, sales or other taxable dispositions of property, other than foreclosure property, held primarily for sale to customers in the ordinary course of business.

- If we fail to satisfy the 75% gross income test or the 95% gross income test, as discussed below, but have otherwise maintained our qualification as a REIT because certain other requirements are met, we will be required to pay a tax equal to the greater of the amount by which we failed to satisfy the 75% or 95% gross income tests, multiplied by a fraction intended to reflect our profitability.

If we fail to satisfy any of the REIT asset tests (other than a *de minimis* failure of the 5% asset test, 10% vote test or the 10% value test), as described below, due to reasonable cause and not due to willful neglect, and we nonetheless maintain our REIT qualification because of specified cure provisions, we will be required to pay a tax equal to the greater of $50,000 or the highest corporate tax rate multiplied by the net income generated by the nonqualifying assets that caused us to fail such test.

If we fail to satisfy any provision of the Code that would result in our failure to qualify as a REIT (other than a violation of the REIT gross income tests or certain violations of the asset tests described below) and the violation is due to reasonable cause and not due to willful neglect, we may retain our REIT qualification but we will be required to pay a penalty of $50,000 for each such failure.

We will be required to pay a 4% excise tax to the extent we fail to distribute, as specially defined in the Code, during each calendar year at least the sum of (1) 85% of our REIT ordinary income for the year, (2) 95% of our REIT capital gain net income for the year, and (3) any undistributed taxable income from prior periods.

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If we acquire any asset in a conversion transaction (which generally refers to a transaction in which the basis of the acquired asset in our hands is determined by reference to the basis of the asset in the hands of a C corporation or partnership that has one or more corporate partners), and we subsequently recognize gain on the disposition of the asset during the ten-year period beginning on the date on which we acquired the asset, then we will be required to pay tax at the highest regular corporate tax rate on this gain to the extent of the excess of (1) the fair market value of the asset over (2) our adjusted basis in the asset, in each case determined as of the date on which we acquired the asset. The results described in this paragraph with respect to the recognition of gain assume that the C corporation or partnership, as applicable, will refrain from making an election to receive different treatment under existing Treasury Regulations on its tax return for the year in which we acquire the asset.

We will be required to pay a 100% tax on any redetermined rents, redetermined deductions or excess interest. See Penalty Tax. In general, redetermined rents are rents from real property that are overstated as a result of services furnished to any of our tenants by a taxable REIT subsidiary of ours. Redetermined deductions and excess interest generally represent amounts that are deducted by a taxable REIT subsidiary of ours for amounts paid to us that are in excess of the amounts that would have been deducted based on arm s length negotiations.

We may be required to pay monetary penalties to the IRS in certain circumstances, including if we fail to meet record-keeping requirements intended to monitor our compliance with rules relating to the composition of our stockholders, as described below in Requirements for Qualification as a REIT.

In addition, we and our subsidiaries may be subject to a variety of taxes other than federal income taxes, including payroll taxes and state, local and foreign income, property or other taxes on assets and operations.

Requirements for Qualification as a REIT. The Code defines a REIT as a corporation, trust or association:

1. that is managed by one or more trustees or directors;

2. that issues transferable shares or transferable certificates to evidence its beneficial ownership;

3. that would be taxable as a domestic corporation, but for Sections 856 through 860 of the Code;

4. that is not a financial institution or an insurance company within the meaning of certain provisions of the Code;

5. that is beneficially owned by 100 or more persons;

6. not more than 50% in value of the outstanding stock of which is owned, actually or constructively, by five or fewer individuals, including, for this purpose, specified entities; and

7. that meets other tests, described below, regarding the nature of its income and assets and the amount of its distributions.

The Code provides that conditions (1) to (4), inclusive, must be met during the entire taxable year, that condition (5) must be met during at least 335 days of a taxable year of 12 months, or during a proportionate part of a taxable year of less than 12 months, and condition (6) must be met during the last half of the taxable year. Conditions (5) and (6) do not apply until after the first taxable year for which an election is made to be taxed as a REIT. For purposes of condition (6), specified tax-exempt entities generally are treated as individuals and a look-through rule applies with respect to pension funds.

We believe that we have been organized, have operated and have issued sufficient shares of capital stock with sufficient diversity of ownership to allow us to satisfy conditions (1) through (7) inclusive, during the relevant time periods. In addition, our charter provides for restrictions regarding ownership and transfer of our shares which are intended to assist us in continuing to satisfy the share ownership requirements described in (5) and (6) above. A description of the transfer restrictions relating to our outstanding common stock is contained

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in Description of Common Stock Restrictions on Ownership in the accompanying prospectus. These restrictions, however, may not ensure that we will, in all cases, be able to satisfy the share ownership requirements described in (5) and (6) above. If we fail to satisfy these share ownership requirements, except as provided in the next sentence, our status as a REIT will terminate. If, however, we comply with the rules contained in applicable Treasury Regulations that require us to ascertain the actual ownership of our shares and we do not know, or would not have known through the exercise of reasonable diligence, that we failed to meet the requirement described in condition (6) above, we will be treated as having met this requirement. To comply with these rules, we must demand written statements each year from the record holders of significant percentages of our capital stock in which the record holders are to disclose the actual owners of the shares, i.e., the persons required to include in gross income the dividends paid by us. A list of those persons failing or refusing to comply with this demand must be maintained as part of our records. Failure by us to comply with these record keeping requirements could subject us to monetary penalties. A stockholder that fails or refuses to comply with the demand is required by Treasury Regulations to submit a statement with its tax return disclosing the actual ownership of the shares and other information.

In addition, we may not maintain our status as a REIT unless our taxable year is the calendar year. We have and will continue to have a calendar taxable year.

Ownership of Interests in Partnerships, Limited Liability Companies and Qualified REIT Subsidiaries. In the case of a REIT which is a partner in a partnership or a member in a limited liability company treated as a partnership for federal income tax purposes, Treasury Regulations provide that the REIT will be deemed to own its proportionate share of the assets of the partnership or limited liability company treated as a partnership, as the case may be, based on its interest in partnership capital, subject to special rules relating to the 10% value test described below. Also, the REIT will be deemed to be entitled to its proportionate share of the income of that entity. The assets and gross income of the partnership or limited liability company retain the same character in the hands of the REIT as in the partnership for purposes of Section 856 of the Code, including satisfying the gross income tests and the asset tests. Thus, our pro rata share of the assets and items of income of our operating partnership, including our operating partnership s share of these items of any entity treated as a partnership or disregarded entity for federal income tax purposes in which it owns an interest, is treated as our assets and items of income for purposes of applying the requirements described in this discussion, including the income and asset tests described below. A brief summary of the rules governing the federal income taxation of partnerships and limited liability companies is set forth below in Tax Aspects of Our Operating Partnership, the Subsidiary Partnerships and the Limited Liability Companies.

We have control of our operating partnership and generally control our subsidiary partnerships and limited liability companies and intend to operate them in a manner consistent with the requirements for our qualification as a REIT. We may from time to time be a non-managing member in some of our partnerships and limited liability companies. If a partnership or limited liability company in which we own an interest takes or expects to take actions that could jeopardize our status as a REIT or require us to pay tax, we may be forced to dispose of our interest in such entity. In addition, it is possible that a partnership or limited liability company could take an action which could cause us to fail a REIT income or asset test, and that we would not become aware of such action in time to dispose of our interest in the partnership or limited liability company or take other corrective action on a timely basis. In that case, we could fail to qualify as a REIT unless we were entitled to relief, as described below.

We may from time to time own and operate certain properties through wholly-owned subsidiaries that we intend to be treated as qualified REIT subsidiaries under the Code. A corporation will qualify as our qualified REIT subsidiary if we own 100% of the corporation s outstanding stock, and if we do not elect with the subsidiary to treat it as a taxable REIT subsidiary, as described below. A corporation that is a qualified REIT subsidiary is not treated as a separate corporation, and all assets, liabilities and items of income, gain, loss, deduction and credit of a qualified REIT subsidiary are treated as assets, liabilities and items of income, gain, loss, deduction and credit (as the case may be) of the parent REIT for all purposes under the Code (including all REIT qualification tests). Thus, in applying the federal tax requirements described in this discussion, any corporations in which we own a 100% interest (other than any taxable REIT subsidiaries) are ignored, and all assets, liabilities and items of income, gain, loss, deduction and credit of such corporations are treated as our assets, liabilities and items of income, gain, loss, deduction and credit. A qualified REIT subsidiary is not required to pay federal income tax, and our ownership of the stock of a qualified REIT subsidiary does not violate the restrictions on ownership of securities, as described below under Asset Tests.

Ownership of Interests in Taxable REIT Subsidiaries. A taxable REIT subsidiary is a corporation other than a REIT in which a REIT directly or indirectly holds stock, and that has made a joint election with such REIT to be treated as a taxable REIT subsidiary. A taxable REIT subsidiary also includes any corporation other than a REIT with respect to which a taxable REIT subsidiary owns securities possessing more than 35% of the total voting power or value of the outstanding securities of such corporation. Other than some activities relating to lodging and health care facilities, a taxable REIT subsidiary may generally engage in any business, including the provision of customary or non-customary services to tenants of its parent REIT. A taxable REIT subsidiary is subject to income tax as a regular C corporation. In addition, a taxable REIT subsidiary may be prevented from deducting interest on debt funded directly or indirectly by its parent REIT if certain tests regarding the taxable REIT subsidiary s debt to equity ratio and interest expense are not satisfied. A REIT s ownership of securities of taxable REIT subsidiaries will not be subject to the 10% vote or value tests or 5% asset test described below. See Asset Tests. We currently own interests in a number of taxable REIT subsidiaries and may acquire securities in additional taxable REIT subsidiaries in the future.

Affiliated REITs. Our operating partnership owned a greater than 10% indirect interest in an entity which elected to be taxed as a REIT for its first taxable year ended December 31, 2009 (the Affiliated REIT), although it has subsequently sold such interest.

Income Tests. We must satisfy two gross income requirements annually to maintain our qualification as a REIT. First, in each taxable year we must derive directly or indirectly at least 75% of our gross income (excluding gross income from prohibited transactions, certain hedging transactions entered into after July 30, 2008, certain foreign currency gains recognized after July 30, 2008 and cancellation of indebtedness income) from investments relating to real property or mortgages on real property, including rents from real property, interest derived from mortgage loans secured by real property (including certain qualified mezzanine financings secured by interests in entities owning real property), dividends from other REITs (such as the Affiliated REIT), gains from the sale of real estate assets and income from certain types of temporary investments. Second, in each taxable year we must derive at least 95% of our gross income (excluding gross income from prohibited transactions, certain hedging transactions entered into on or after January 1, 2005, certain foreign currency gains recognized after July 30, 2008 and cancellation of indebtedness income) from the real property investments described above or dividends, interest and gain from the sale or disposition of stock or securities, or from any combination of the foregoing. For these purposes, the term interest generally does not include any amount received or accrued, directly or indirectly, if the determination of all or some of the amount depends in any way on the income or profits of any person. However, an amount received or accrued generally will not be excluded from the term interest solely by reason of being based on a fixed percentage or percentages of receipts or sales.

Rents we receive from a tenant will qualify as rents from real property for the purpose of satisfying the gross income requirements for a REIT described above only if all of the following conditions are met:

The amount of rent is not based in any way on the income or profits of any person. However, an amount we receive or accrue generally will not be excluded from the term rents from real property solely because it is based on a fixed percentage or percentages of receipts or sales;

We, or an actual or constructive owner of 10% or more of our capital stock, do not actually or constructively own 10% or more of the interests in a tenant, or, if the tenant is a corporation, 10% or more of the voting power or value of all classes of stock of the tenant. Rents received from such a tenant that is a taxable REIT subsidiary, however, will not be excluded from the definition of rents from real property as a result of this condition if at least 90% of the space at the property to which the

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rents relate is leased to third parties, and the rents paid by the taxable REIT subsidiary are substantially comparable to rents paid by our other tenants for comparable space. Whether rents paid by a taxable REIT subsidiary are substantially comparable to rents paid by other tenants is determined at the time the lease with the taxable REIT subsidiary is entered into, extended, or modified, if such modification increases the rents due under such lease. Notwithstanding the foregoing, however, if a lease with a controlled taxable REIT subsidiary is modified and such modification results in an increase in the rents payable by such taxable REIT subsidiary, any such increase will not qualify as rents from real property. For purposes of this rule, a controlled taxable REIT subsidiary is a taxable REIT subsidiary in which we own stock possessing more than 50% of the voting power or more than 50% of the total value of the outstanding stock of such taxable REIT subsidiary;

Rent attributable to personal property leased in connection with a lease of real property is not greater than 15% of the total rent received under the lease. Rent is allocated between real property and personal property based on the relative fair market values of the properties. If this condition is not met, then the portion of the rent attributable to personal property will not qualify as rents from real property ; and

We do not operate or manage the property (subject to certain exceptions) or furnish or render services to our tenants, except as provided below. We may, however, perform services that are usually or customarily rendered in connection with the rental of space for occupancy only and are not otherwise considered rendered to the occupant of the property. Examples of these services include the provision of light, heat, or other utilities, trash removal and general maintenance of common areas. Moreover, we may provide non-customary services to tenants of a particular property without disqualifying all of the rent from that property if the payment for such services does not exceed 1% of the total gross income from the property. For purposes of this test, the income received from such non-customary services is deemed to be at least 150% of the direct cost of providing the services. In addition, we may employ an independent contractor from whom we derive no revenue, or a taxable REIT subsidiary, which may be wholly or partially owned by us, to provide both customary and non-customary services to our tenants without causing the rent we receive from those tenants to fail to qualify as rents from real property.

We generally do not intend, and as a general partner of our operating partnership do not intend to permit our operating partnership, to take actions we believe will cause us to fail to satisfy the rental conditions described above. However, there can be no assurance that the IRS will agree with our determination that we have satisfied the rental conditions described above.

In certain circumstances, we or our operating partnership receive fees for property management and brokerage and leasing services provided with respect to some properties not owned entirely by our operating partnership. These fees, to the extent paid with respect to the portion of these properties not owned, directly or indirectly, by us, will not qualify under the 75% gross income test or the 95% gross income test. Our operating partnership also may receive other types of income with respect to the properties it owns that will not qualify for either of these tests. We believe, however, that the aggregate amount of these fees and other non-qualifying income in any taxable year will not cause us to exceed the limits on non-qualifying income under either the 75% gross income test or the 95% gross income test.

From time to time, we may enter into hedging transactions with respect to one or more of our assets or liabilities. Our hedging activities may include entering into interest rate swaps, caps, and floors, options to purchase these items, and futures and forward contracts. Income from a hedging transaction, including gain from the sale or disposition of such a transaction, that is treated as clearly identified as a hedging transaction on the date it is entered into or acquired and satisfies certain other identification requirements will not constitute gross income and thus will be ignored for purposes of the 95% gross income test to the extent such a hedging transaction is entered into on or after January 1, 2005, and will not constitute gross income and thus will be ignored for purposes of the 75% gross income test to the extent such hedging transaction is entered into after July 30, 2008. Income and gain from a hedging transaction, including gain from the sale or disposition of such a transaction, entered into on or prior to July 30, 2008 will be treated as nonqualifying income for purposes of the 75% gross income test. Income and gain from a hedging transaction, including gain from the sale or disposition of such a transaction, entered into prior to January 1, 2005 will be qualifying income for purposes of the 95% gross income test. The term hedging transaction, as used herein, generally means any transaction we enter into in the normal course of our business primarily to manage risk of (1) interest rate changes or fluctuations with respect to borrowings made or to be made by us to acquire or carry real estate assets, or (2) for hedging transactions entered into after July 30, 2008, currency fluctuations with respect to an item of qualifying income under the 75% or 95% gross income test. To the extent that we do not properly identify such transactions as hedges or we hedge with other types of financial instruments, or our hedge is not a hedging transaction, the income from those transactions is not likely to be treated as qualifying income for purposes of the gross income tests. We intend to structure any hedging transactions in a manner that does not jeopardize our status as a REIT.

To the extent our taxable REIT subsidiaries pay dividends, we generally will derive our allocable share of such dividend income through our interest in our operating partnership. Such dividend income will qualify under the 95%, but not the 75%, gross income test. We will monitor the amount of the dividend and other income from our taxable REIT subsidiaries and will take actions intended to keep this income, and any other nonqualifying income, within the limitations of the REIT income tests. While we expect these actions will prevent a violation of the REIT income tests, we cannot guarantee that such actions will in all cases prevent such a violation.

If we fail to satisfy one or both of the 75% or 95% gross income tests for any taxable year, we may nevertheless qualify as a REIT for the year if we are entitled to relief under certain provisions of the Code. Commencing with our taxable year beginning January 1, 2005, we generally may make use of the relief provisions if:

- following our identification of the failure to meet the 75% or 95% gross income tests for any taxable year, we file a schedule with the IRS setting forth each item of our gross income for purposes of the 75% or 95% gross income tests for such taxable year in accordance with Treasury Regulations to be issued; and

- our failure to meet these tests was due to reasonable cause and not due to willful neglect.

It is not possible, however, to state whether in all circumstances we would be entitled to the benefit of these relief provisions. If these relief provisions do not apply to a particular set of circumstances, we will not qualify as a REIT. As discussed above in Taxation of Our Company, even if these relief provisions apply, and we retain our status as a REIT, a tax would be imposed with respect to our nonqualifying income.

Prohibited Transaction Income. Any gain that we realize (including any net foreign currency gain recognized after July 30, 2008) on the sale of property held as inventory or otherwise held primarily for sale to customers in the ordinary course of business, including our share of any such gain realized by our operating partnership, either directly or through its subsidiary partnerships and limited liability companies, will be treated as income from a prohibited transaction that is subject to a 100% penalty tax, unless certain safe harbor exceptions apply. This prohibited transaction income may also adversely affect our ability to satisfy the income tests for qualification as a REIT. Under existing law, whether property is held as inventory or primarily for sale to customers in the ordinary course of a trade or business is a question of fact that depends on all the facts and circumstances surrounding the particular transaction. However, the Code provides a safe harbor pursuant to which limited sales of properties held at least four years and meeting certain additional requirements will not be treated as prohibited transactions. In the case of sales made after July 30, 2008, the required holding period has been reduced to two years, and one of the other requirements has been modified in a manner that may permit us to qualify more sales under the safe harbor provisions. Our operating partnership generally intends to hold its properties for investment with a view to long-term appreciation, and to engage in the business of acquiring, developing and owning its properties. However, in keeping with our stated goal of reducing overall leverage by selling non-core and limited growth potential assets, our operating partnership has sold and intends to continue to sell a significant number of those properties. Some sales of property by our operating partnership or its subsidiary partnerships or limited liability companies may not qualify for the safe harbor, and in those cases, the IRS may successfully contend that some or all of such sales are prohibited transactions. We would be required to pay the 100% penalty tax on our allocable share of the gains resulting from any such sales.

Penalty Tax. Any redetermined rents, redetermined deductions or excess interest we generate will be subject to a 100% penalty tax. In general, redetermined rents are rents from real property that are overstated as a result of any services furnished to any of our tenants by one of our taxable REIT subsidiaries, and redetermined deductions and excess interest represent any amounts that are deducted by a taxable REIT subsidiary for amounts paid to us that are in excess of the amounts that would have been deducted based on arm s-length negotiations. Rents we receive will not constitute redetermined rents if they qualify for certain safe harbor provisions contained in the Code.

Our taxable REIT subsidiaries may provide services to our tenants. The fees paid to our taxable REIT subsidiaries may not satisfy the safe-harbor provisions described above. These determinations are inherently factual, and the IRS has broad discretion to assert that amounts paid between related parties should be reallocated to clearly reflect their respective incomes. If the IRS successfully made such an assertion, we would be required to pay a 100% penalty tax on the excess of an arm s-length fee for tenant services over the amount actually paid.

Asset Tests. At the close of each quarter of our taxable year, we must also satisfy four tests relating to the nature and diversification of our assets. First, at least 75% of the value of our total assets must be represented by real estate assets, cash, cash items and government securities. For purposes of this test, the term real estate assets generally means real property (including interests in real property, interests in mortgages on real property and certain qualified mezzanine financings secured by interests in entities owning real property) and shares (or transferable certificates of beneficial interest) in other REITs, as well as any stock or debt instrument attributable to the investment of the proceeds of a stock offering or a public offering of debt with a term of at least five years, but only for the one-year period beginning on the date the REIT receives such proceeds.

Second, not more than 25% of the value of our total assets may be represented by securities, other than those securities includable in the 75% asset test.

Third, of the investments included in the 25% asset class, and except for investments in other REITs, our qualified REIT subsidiaries and taxable REIT subsidiaries, the value of any one issuer s securities may not exceed 5% of the value of our total assets, and we may not own more than 10% of the total vote or value of the outstanding securities of any one issuer except, in the case of the 10% value test, securities satisfying the straight debt safe-harbor or securities issued by a partnership that itself would satisfy the 75% income test if it were a REIT. Certain types of securities we may own are disregarded as securities solely for purposes of the 10% value test, including, but not limited to, any loan to an individual or an estate, any obligation to pay rents from real property and any security issued by a REIT. In addition, commencing with our taxable year beginning January 1, 2005, solely for purposes of the 10% value test, the determination of our interest in the assets of a partnership or limited liability company in which we own an interest will be based on our proportionate interest in any securities issued by the partnership or limited liability company, excluding for this purpose certain securities described in the Code.

Fourth, not more than 25% (20% for taxable years ending on or before December 31, 2008) of the value of our total assets may be represented by the securities of one or more taxable REIT subsidiaries.

Our operating partnership owns 100% of the stock of certain corporations that have elected, together with us, to be treated as our taxable REIT subsidiaries and our operating partnership owned a 20% interest in the Affiliated REIT, which elected to be taxed as a REIT. So long as each of those wholly owned companies qualified as a taxable REIT subsidiary and the Affiliated REIT qualified as a REIT through 2012, we will not be subject to the 5% asset test or the

10% vote or value tests with respect to our ownership of their stock. We may acquire securities in other taxable REIT subsidiaries or REITs in the future. We believe that the aggregate value of our taxable REIT subsidiaries has not exceeded 20% of the aggregate value of our gross assets in any taxable year ending on or before December 31, 2008, or 25% of the aggregate value of our gross assets for taxable years ending after December 31, 2008. No independent appraisals have been obtained to support these conclusions and there can be no assurance that the IRS will agree with our determinations of value.

The asset tests must be satisfied at the close of each calendar quarter of our taxable year in which we (directly or through our operating partnership) acquire securities in the applicable issuer, and also at the close of each calendar quarter in which we increase our ownership of securities of such issuer. After initially meeting the asset tests at the close of any quarter, we will not lose our status as a REIT for failure to satisfy the asset tests at the end of a later quarter solely by reason of changes in asset values. If we fail to satisfy an asset test because we acquire securities or other property during a quarter, we may cure this failure by disposing of sufficient nonqualifying assets within 30 days after the close of that quarter. We believe that we have maintained and intend to maintain adequate records of the value of our assets to ensure compliance with the asset tests. If we fail to cure any noncompliance with the asset tests within the 30-day cure period, we would cease to qualify as a REIT unless we are eligible for certain relief provisions discussed below.

Certain relief provisions may be available to us if we discover a failure to satisfy the asset tests described above after the 30-day cure period. Under these provisions, we will be deemed to have met the 5% asset test and 10% vote or value tests if the value of our nonqualifying assets (i) does not exceed the lesser of (a) 1% of the total value of our assets at the end of the applicable quarter or (b) $10,000,000, and (ii) we dispose of the nonqualifying assets or otherwise satisfy such tests within (a) six months after the last day of the quarter in which the failure to satisfy the asset tests is discovered or (b) the period of time prescribed by Treasury Regulations to be issued. For violations of any of the asset tests due to reasonable cause and not due to willful neglect and that are, in the case of the 5% asset test and 10% vote or value tests, in excess of the de minimis exception described above, we may avoid disqualification as a REIT after the 30-day cure period by taking steps including (i) the disposition of sufficient nonqualifying assets, or the taking of other actions, which allow us to meet the asset test within (a) six months after the last day of the quarter in which the failure to satisfy the asset tests is discovered or (b) the period of time prescribed by Treasury Regulations to be issued, (ii) paying a tax equal to the greater of (a) $50,000 or (b) the highest corporate tax rate multiplied by the net income generated by the nonqualifying assets, and (iii) disclosing certain information to the IRS.

Although we believe we have satisfied the asset tests described above and plan to take steps to ensure that we satisfy such tests for any quarter with respect to which retesting is to occur, there can be no assurance we will always be successful, or will not require a reduction in our operating partnership s overall interest in an issuer (including in a taxable REIT subsidiary). If we fail to cure any noncompliance with the asset tests in a timely manner, and the relief provisions described above are not available, we would cease to qualify as a REIT.

Annual Distribution Requirements. To maintain our qualification as a REIT, we are required to distribute dividends, other than capital gain dividends, to our stockholders in an amount at least equal to the sum of:

90% of our REIT taxable income ; and

90% of our after tax net income, if any, from foreclosure property; minus

the excess of the sum of certain items of non-cash income over 5% of our REIT taxable income.

For these purposes, our REIT taxable income is computed without regard to the dividends paid deduction and our net capital gain. In addition, for purposes of this requirement, non-cash income means income attributable to leveled stepped rents, original issue discount on purchase money debt, cancellation of indebtedness, or a like-kind exchange that is later determined to be taxable.

In addition, if we dispose of any asset we acquired in a conversion transaction within the ten-year period following our acquisition of such asset, we would be required to distribute at least 90% of the after-tax gain, if any, we recognized on the disposition of the asset, to the extent that gain does not exceed the excess of (a) the fair market value of the asset over (b) our adjusted basis in the asset, in each case, on the date we acquired the asset.

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We generally must pay, or be treated as paying, the distributions described above in the taxable year to which they relate. At our election, a distribution will be treated as paid in a taxable year if it is declared before we timely file our tax return for such year and paid on or before the first regular dividend payment after such declaration, provided such payment is made during the 12-month period following the close of such year. These distributions are taxable to our stockholders, other than tax-exempt entities, in the year in which paid. This is so even though these distributions relate to the prior year for purposes of the 90% distribution requirement. The amount distributed must not be preferential i.e., every stockholder of the class of stock to which a distribution is made must be treated the same as every other stockholder of that class, and no class of stock may be treated otherwise than according to its dividend rights as a class. To the extent that we do not distribute all of our net capital gain, or distribute at least 90%, but less than 100%, of our REIT taxable income, as adjusted, we will be required to pay tax on the undistributed amount at regular corporate tax rates. We believe we have made, and intend to continue to make, timely distributions sufficient to satisfy these annual distribution requirements and to minimize our corporate tax obligations.

We expect to have sufficient cash or liquid assets to enable us to satisfy the distribution requirements described above. However, if we do not have sufficient cash we may be required to borrow funds to pay dividends or pay dividends in the form of taxable stock dividends or taxable in-kind distributions of property in order to meet the distribution requirements.

We may satisfy the 90% distribution test with taxable distributions of our stock or debt securities. The IRS has issued private letter rulings to other REITs treating certain distributions that are paid partly in cash and partly in stock as dividends that would satisfy the REIT annual distribution requirement and qualify for the dividends paid deduction for federal income tax purposes. Those rulings may be relied upon only by the taxpayers to whom they were issued, although we could request a similar ruling from the IRS. Accordingly, it is unclear whether and to what extent we will be able to make taxable dividends payable in cash and stock. We have no current intention to make a taxable dividend payable in our stock.

Under some circumstances, we may be able to rectify an inadvertent failure to meet the 90% distribution requirement for a year by paying deficiency dividends to our stockholders in a later year, which may be included in our deduction for dividends paid for the earlier year. Thus, we may be able to avoid being taxed on amounts distributed as deficiency dividends, subject to the 4% excise tax described below. However, we will be required to pay interest to the IRS based upon the amount of any deduction claimed for deficiency dividends.

Furthermore, we will be required to pay a 4% excise tax to the extent we fail to distribute during each calendar year at least the sum of 85% of our REIT ordinary income for such year, 95% of our REIT capital gain income for the year and any undistributed taxable income from prior periods.

For purposes of the distribution requirements and excise tax described above, dividends declared during the last three months of the taxable year, payable to stockholders of record on a specified date during such period and paid during January of the following year, will be treated as paid by us and received by our stockholders on December 31 of the year in which they are declared.

Like-Kind Exchanges. We may dispose of properties in transactions intended to qualify as like-kind exchanges under the Code. Such like-kind exchanges are intended to result in the deferral of gain for federal income tax purposes. The failure of any such transaction to qualify as a like-kind exchange could subject us to federal income tax, possibly including the 100% prohibited transaction tax, depending on the facts and circumstances surrounding the particular transaction.

Failure To Qualify. Commencing with our taxable year beginning January 1, 2005, specified cure provisions are available to us in the event that we discover a violation of a provision of the Code that would result in our failure to qualify as a REIT. Except with respect to violations of the REIT income tests and asset tests (for which the cure provisions are described above), and provided the violation is due to reasonable cause and not due to willful neglect, these cure provisions generally impose a $50,000 penalty for each violation in lieu of a loss of REIT status. If we fail to qualify for taxation as a REIT in any taxable year, and the relief provisions do not apply, we will be required to pay tax, including any applicable alternative minimum tax, on our taxable income at regular corporate rates. Distributions to stockholders in any year in which we fail to qualify as a REIT will not be deductible by us, and we will not be required to distribute any amounts to our stockholders. As a result, we anticipate that our failure to qualify as a REIT would reduce the cash available for distribution by us to our stockholders. In addition, if we fail to qualify as a REIT, all distributions to stockholders will be taxable as regular corporate dividends to the extent of our current and accumulated earnings and profits. In this event, corporate distributees may be eligible for the dividends-received deduction. In addition, individuals may be eligible for the preferential rates on qualified dividend income. Unless entitled to relief under specific statutory provisions, we will also be ineligible to elect to be treated as a REIT for the four taxable years following the year during which we lost our qualification. It is not possible to state whether in all circumstances we would be entitled to this statutory relief.

Tax Aspects of Our Operating Partnership, the Subsidiary Partnerships and the Limited Liability Companies

General. All of our investments are held indirectly through our operating partnership. In addition, our operating partnership holds certain of its investments indirectly through subsidiary partnerships and limited liability companies which, other than with respect to the PW Gyms, LLC, which has elected to be treated as a corporation, we expect will be treated as partnerships or disregarded entities for federal income tax purposes. In general, entities that are classified as partnerships or disregarded entities for federal income tax purposes are pass-through entities which are not required to pay federal income tax. Rather, partners or members of such entities are allocated their shares of the items of income, gain, loss, deduction and credit of the partnership or limited liability company, and are potentially required to pay tax on this income, without regard to whether they receive a distribution from the partnership or limited liability company. We will include in our income our share of these partnership and limited liability company items for purposes of the various REIT income tests and in the computation of our REIT taxable income. Moreover, for purposes of the REIT asset tests, we will include our pro rata share of assets held by our operating partnership, including its share of the assets of its subsidiary partnerships and limited liability companies, based on our capital interests. See Taxation of Our Company.

Entity Classification. Our interests in our operating partnership and the subsidiary partnerships and limited liability companies involve special tax considerations, including the possibility that the IRS might challenge the status of these entities as partnerships (or disregarded entities), as opposed to associations taxable as corporations for federal income tax purposes. If our operating partnership or a subsidiary partnership or limited liability company were treated as an association, it would be taxable as a corporation and would be required to pay an entity-level tax on its income. In this situation, the character of our assets and items of gross income would change and could prevent us from satisfying the REIT asset tests and possibly the REIT income tests. See Taxation of Our Company Asset Tests and Income Tests. This, in turn, could prevent us from qualifying as a REIT. See Taxation of Our Company Failure to Qualify for a discussion of the effect of our failure to meet these tests. In addition, a change in the tax status of our operating partnership, a subsidiary partnership or limited liability company might be treated as a taxable event. If so, we might incur a tax liability without any related cash distributions. We believe our operating partnership and each of our other partnerships and limited liability companies (other than PW Gyms, LLC) will be classified as partnerships or disregarded entities for federal income tax purposes.

Allocations of Income, Gain, Loss and Deduction. An entity taxed as a partnership is not a taxable entity for federal income tax purposes. Rather, a partner is required to take into account its allocable share of a partnership s income, gains, losses, deductions and credits for any taxable year of the partnership ending within or with the taxable year of the partner, without regard to whether the partner has received or will receive any distributions from the partnership. Although a partnership agreement will generally determine the allocation of income and losses among partners, such allocations will be disregarded for tax purposes if they do not comply with the provisions of Section 704(b) of the Code and the Treasury Regulations promulgated thereunder as to substantial economic effect.

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If an allocation is not recognized for federal income tax purposes because it does not have substantial economic effect, the item subject to the allocation will be reallocated in accordance with the partners interests in the partnership. This reallocation will be determined by taking into account all of the facts and circumstances relating to the economic arrangement of the partners with respect to such item. The allocations of taxable income and loss of our operating partnership and the subsidiary partnerships are intended to comply with the requirements of Section 704(b) of the Code and the Treasury Regulations thereunder.

Tax Allocations With Respect to the Properties. Under Section 704(c) of the Code, income, gain, loss and deduction attributable to appreciated or depreciated property that is contributed to a partnership in exchange for an interest in the partnership, must be allocated in a manner so that the contributing partner is charged with the unrealized gain or benefits from the unrealized loss associated with the property at the time of the contribution. The amount of the unrealized gain or unrealized loss generally is equal to the difference between the fair market value or book value and the adjusted tax basis of the contributed property at the time of contribution, as adjusted from time to time. These allocations are solely for federal income tax purposes and do not affect the book capital accounts or other economic or legal arrangements among the partners.

To the extent our operating partnership or any subsidiary partnership acquires appreciated (or depreciated) properties by way of capital contributions from its partners, allocations would need to be made in a manner consistent with these requirements. Where a partner contributes cash to a partnership at a time when the partnership holds appreciated (or depreciated) property, the Treasury Regulations provide for a similar allocation of these items to the other (i.e., non-contributing) partners. As a result, partners, including us, in our operating partnership or any subsidiary partnership could be allocated greater or lesser amounts of depreciation and taxable income in respect of the applicable partnership s properties than would be the case if all of the partnership s assets (including any contributed assets) had a tax basis equal to their fair market values at the time of any contributions to that partnership. This could cause us to recognize, over a period of time, taxable income in excess of cash flow from the partnership, which might adversely affect our ability to comply with the REIT distribution requirements discussed above in Taxation of Our Company Annual Distribution Requirements.

Any property acquired by our operating partnership in a taxable transaction will initially have a tax basis equal to its fair market value and Section 704(c) of the Code will not apply.

Taxation of U.S. Holders on Distributions in Respect of Common Stock

Distributions on the common stock generally will be includable in your income as dividends to the extent the distributions do not exceed our allocable current and accumulated earnings and profits, with a portion of these dividends possibly treated as capital gain dividends as explained below, but with no portion of these dividends eligible for either the dividends received deduction for corporate stockholders or, except in limited circumstances, the 20% maximum rfont-family:Times New Roman">First half

109

73

182

$64.23

	$65.30
	$64.66
Second half	
	111
	73
	184
	64.23
	65.30
	64.66
12 months	
	220
	146
	366
	64.23
	65.30
	64.66

QUESTAR CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

	3 Months Ended June 30,		6 Months Ended June 30,	
	2006	2005	2006	2005
	(in thousands, except per share amounts)			
REVENUES				
Market Resources	$384,110	$344,896	$799,187	$659,234
Questar Pipeline	24,912	19,087	50,354	36,999
Questar Gas	181,853	151,043	648,792	494,733
Corporate and other operations	5,355	5,183	9,270	9,567
TOTAL REVENUES	596,230	520,209	1,507,603	1,200,533
OPERATING EXPENSES				
Cost of natural gas and other products sold	220,854	225,577	683,634	564,382
Operating and maintenance	68,244	63,312	142,353	120,059
General and administrative	30,292	29,647	62,610	62,730
Production and other taxes	25,864	26,250	59,336	52,635
Depreciation, depletion and amortization	73,269	59,807	146,023	118,632
Exploration	10,101	5,476	13,400	6,849
Abandonment and impairment of gas, oil and other properties	1,843	1,493	3,542	2,898
TOTAL OPERATING EXPENSES	430,467	411,562	1,110,898	928,185
OPERATING INCOME	165,763	108,647	396,705	272,348
Interest and other income	3,710	2,922	6,157	5,573
Income from unconsolidated affiliates	1,701	1,675	3,532	3,221
Unrealized mark-to-market loss on basis swaps	(5,614)		(5,614)	
Loss from early extinguishment of debt	(1,746)		(1,746)	
Interest expense	(19,762)	(16,643)	(37,192)	(33,365)
INCOME BEFORE INCOME TAXES	144,052	96,601	361,842	247,777
Income taxes	53,690	35,874	134,324	91,879
NET INCOME	$90,362	$60,727	$227,518	$155,898
EARNINGS PER COMMON SHARE				
Basic	$1.06	$0.71	$2.67	$1.84

Diluted	1.03	0.70	2.60	1.79
Weighted average common shares outstanding				
Used in basic calculation	85,352	84,679	85,301	84,546
Used in diluted calculation	87,492	87,051	87,475	86,888
Dividends per common share	$0.235	$0.225	$0.46	$0.44

QUESTAR CORPORATION
OPERATIONS BY LINE OF BUSINESS
(Unaudited)

	3 Months Ended June 30,		6 Months Ended June 30,	
	2006	2005	2006	2005
	(in thousands)			
REVENUES FROM UNAFFILIATED CUSTOMERS				
Questar E&P	$198,385	$137,350	$409,172	$269,847
Wexpro	3,669	3,425	9,972	8,551
Gas Management	40,485	33,148	81,733	62,182
Energy Trading and other	141,571	170,973	298,310	318,654
Market Resources total	384,110	344,896	799,187	659,234
Questar Pipeline	24,912	19,087	50,354	36,999
Questar Gas	181,853	151,043	648,792	494,733
Corporate and other operations	5,355	5,183	9,270	9,567
	$596,230	$520,209	$1,507,603	$1,200,533
REVENUES FROM AFFILIATED CUSTOMERS				
Wexpro	$36,517	$33,204	$75,243	$66,188
Gas Management	3,632	3,400	7,478	6,588
Energy Trading and other	158,948	131,541	409,178	273,755
Market Resources total	199,097	168,145	491,899	346,531
Questar Pipeline	19,827	21,517	40,393	43,942
Questar Gas	1,237	1,370	2,814	2,631
Corporate and other operations	408	473	836	1,075
	$220,569	$191,505	$535,942	$394,179
OPERATING INCOME (LOSS)				
Questar E&P	$104,206	$60,518	$222,893	$123,960
Wexpro	18,294	15,871	36,511	31,749
Gas Management	15,104	13,115	29,772	26,058
Energy Trading and other	784	1,559	4,095	4,014
Market Resources total	138,388	91,063	293,271	185,781
Questar Pipeline	21,729	17,346	45,659	35,703
Questar Gas	2,735	(2,122)	54,242	47,829
Corporate and other operations	2,911	2,360	3,533	3,035
	$165,763	$108,647	$396,705	$272,348

NET INCOME (LOSS)				
Questar E&P	$56,100	$34,426	$126,590	$70,677
Wexpro	11,957	10,495	23,942	20,677
Gas Management	10,186	8,962	19,924	17,770
Energy Trading and other	1,042	878	3,494	2,258
Market Resources total	79,285	54,761	173,950	111,382
Questar Pipeline	9,884	7,593	21,323	15,932
Questar Gas	(693)	(3,446)	28,671	25,266
Corporate and other operations	1,886	1,819	3,574	3,318
	$90,362	$60,727	$227,518	$155,898

QUESTAR CORPORATION
SELECTED OPERATING STATISTICS
(Unaudited)

	3 Months Ended June 30,		6 Months Ended June 30,	
	2006	2005	2006	2005
MARKET RESOURCES				
Questar E&P production volumes				
Natural gas (MMcf)	27,561	23,410	56,117	46,249
Oil and natural gas liquids (Mbbl)	620	586	1,243	1,169
Total production (Bcfe)	31.3	26.9	63.6	53.3
Average daily production (MMcfe)	344	296	351	294
Questar E&P average commodity price, net to the well				
Average realized price (including hedges)				
Natural gas (per Mcf)	$6.00	$4.82	$6.13	$4.79
Oil and natural gas liquids (per bbl)	$50.11	$40.02	$50.27	$39.38
Wexpro net investment base at June 30, (millions)	$220.1	$188.0		
Natural gas gathering volumes (in thousands of MMBtu) (1)				
For unaffiliated customers	35,784	33,539	68,434	66,074
For Questar Gas	9,679	11,226	20,242	22,482
For other affiliated customers	16,977	14,416	34,993	30,262
Total gathering	62,440	59,181	123,669	118,818
Gathering revenue (per MMBtu)	$0.29	$0.25	$0.29	$0.25
Natural gas and oil marketing volumes (Mdthe)				
For unaffiliated customers	25,755	26,347	55,287	55,256
For affiliated customers	24,316	22,095	49,878	44,647
Total marketing	50,071	48,442	105,165	99,903
QUESTAR PIPELINE				
Natural gas transportation volumes (Mdth)				
For unaffiliated customers	78,159	61,393	140,876	116,995
For Questar Gas	27,281	26,212	68,138	69,951
For other affiliated customers	5,828	6,505	9,574	8,481
Total transportation	111,268	94,110	218,588	195,427
Transportation revenue (per dth)	$0.27	$0.28	$0.27	$0.27

Firm-daily transportation demand (Mdth)	2,135	1,815		
QUESTAR GAS				
Natural gas volumes (Mdth)				
Residential and commercial sales	16,692	16,843	58,957	56,762
Industrial sales	1,126	1,394	2,277	3,097
Transportation for industrial customers	7,384	7,068	15,869	15,723
Total deliveries	25,202	25,305	77,103	75,582
Natural gas revenue (per dth)				
Residential and commercial sales	$9.73	$7.82	$10.24	$7.99
Industrial sales	7.44	6.24	7.91	6.17
Transportation for industrial customers	$0.19	$0.18	$0.19	$0.18
Heating degree days				
colder (warmer) than normal	(25%)	6%	(7%)	(3%)
Temperature-adjusted usage per				
customer (dth)	18.1	18.2	68.5	68.1
Customers at June 30,	835,511	798,277		

(1) one dth = one MMBtu

QUESTAR CORPORATION
PRELIMINARY CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

	June 30, 2006	December 31, 2005
	(in thousands)	
ASSETS		
Current assets		
Cash and cash equivalents	$73,760	$13,360
Accounts and notes receivable, net	240,019	458,395
Fair value of hedging contracts	4,482	1,972
Inventories	94,585	125,417
Deferred income taxes - current	36,901	86,734
Other current assets	24,076	69,962
Total current assets	473,823	755,840
Property, plant and equipment	5,822,528	5,527,997
Less accumulated depreciation,		
depletion and amortization	2,183,778	2,100,455
Net property, plant and equipment	3,638,750	3,427,542
Investment in unconsolidated affiliates	33,915	30,681
Goodwill	71,260	71,260
Other assets, net	72,273	71,750
	$4,290,021	$4,357,073
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Short-term debt		$94,500
Accounts payable and accrued expenses	$350,649	557,025
Fair value of hedging contracts	28,548	222,049
Total current liabilities	379,197	873,574
Long-term debt	1,032,374	983,200
Deferred income taxes	699,515	624,187
Fair value of hedging contracts	17,270	99,044
Other long-term liabilities	237,676	227,265
Common shareholders' equity	1,923,989	1,549,803
	$4,290,021	$4,357,073

QUESTAR CORPORATION
PRELIMINARY CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	6 Months Ended June 30,	
	2006	2005
	(in thousands)	
Operating activities		
Net income	$227,518	$155,898
Adjustments to reconcile net income to net cash provided from operating activities:		
Depreciation, depletion and amortization	150,432	122,445
Deferred income taxes	17,813	20,555
Share-based compensation	4,444	2,026
Abandonment and impairment of gas, oil and other properties	3,542	2,898
Income from unconsolidated affiliates, net of cash distributions	(709)	(1,004)
Net gain from asset sales	(181)	(3,594)
Loss from early extinguishment of debt	1,746	
Unrealized mark-to-market loss on basis swaps	5,614	
Ineffective portion of fixed-price swaps	(259)	328
Change in operating assets and liabilities	93,129	26,794
Net cash provided from operating activities	503,089	326,346
Investing activities		
Capital expenditures	(362,451)	(283,120)
Proceeds from asset dispositions	2,771	16,380
Net cash used in investing activities	(359,680)	(266,740)
Financing activities		
Common stock	1,394	5,664
Short-term debt	(94,500)	(31,000)
Long-term debt	45,201	(5)
Dividends paid	(39,354)	(37,289)
Excess tax benefits from share-based compensation	4,250	
Net cash used in financing activities	(83,009)	(62,630)
Change in cash and cash equivalents	60,400	(3,024)
Beginning cash and cash equivalents	13,360	3,681

Ending cash and cash equivalents	$73,760	$657