

CHELSEA PROPERTY GROUP INC  
Form 10-Q  
November 14, 2001

---

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

---

FORM 10-Q

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

For the quarterly period ended September 30, 2001

or

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

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

**Commission File No. 1-12328**

**CHELSEA PROPERTY GROUP, INC.**

(Exact name of registrant as specified in its charter)

**Maryland**

(State or other jurisdiction  
of incorporation or organization)

**22-3251332**

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

**103 Eisenhower Parkway, Roseland, New Jersey 07068** (Address of principal executive offices - zip code)

**(973) 228-6111**

(Registrant's telephone number, including area code)

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

The number of shares outstanding of the registrant's common stock, \$0.01 par value was 18,736,842 at November 8, 2001.

**Chelsea Property Group, Inc.**

Index

**Part I. Financial Information**

Item 1. Financial Statements (Unaudited)

Page

Edgar Filing: CHELSEA PROPERTY GROUP INC - Form 10-Q

Condensed Consolidated Balance Sheets as of September 30, 2001 and December 31, 2000	3
Condensed Consolidated Statements of Income for the three and nine months ended September 30, 2001 and 2000	4
Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2001 and 2000	5
Notes to Condensed Consolidated Financial Statements	6
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	18
Item 3. Quantitative and Qualitative Disclosures about Market Risk	25
<b>Part II. Other Information</b>	
Item 6. Exhibits and Reports on Form 8-K	27
Signatures	28

**Item 1. Financial Statements**

**Chelsea Property Group, Inc.**  
**Condensed Consolidated Balance Sheets**  
*(In thousands, except per share data)*

	September 30, 2001	December 31, 2000
	-----	-----
Assets	(Unaudited)	
Rental properties:		
Land.....	\$ 151,029	\$ 118,238
Depreciable property.....	953,700	790,106
	-----	-----
Total rental property.....	1,104,729	908,344
Accumulated depreciation.....	(205,544)	(175,692)
	-----	-----
Rental properties, net.....	899,185	732,652
Properties held for sale.....	14,736	-
Cash and cash equivalents.....	16,290	18,036
Restricted cash-escrows.....	10,185	-
Investments in affiliates.....	97,193	91,629
Deferred costs, net.....	19,957	14,886
Notes receivable-related parties.....	3,241	2,216
Other assets.....	30,536	41,895
	-----	-----
Total assets.....	\$ 1,091,323	\$ 901,314
	=====	=====
Liabilities and stockholders' equity		
Liabilities:		

Edgar Filing: CHELSEA PROPERTY GROUP INC - Form 10-Q

Unsecured bank debt.....	\$ 22,035	\$ 35,035
Unsecured Notes due 2001 - 2011.....	373,239	324,542
Mortgage debt.....	233,499	90,776
Construction payables.....	6,063	10,001
Accounts payable and accrued expenses.....	37,752	43,507
Obligation under capital lease.....	2,284	2,714
Accrued dividend and distribution payable.....	16,909	3,910
Other liabilities.....	15,177	18,267
	-----	-----
Total liabilities.....	706,958	528,752
Commitments and contingencies		
Minority interest.....	96,695	101,203
Stockholders' equity:		
8.375% series A cumulative redeemable preferred stock, \$0.01 par value, authorized 1,000 shares, issued and outstanding 1,000 shares in 2001 and 2000 (aggregate liquidation preference \$50,000).....	10	10
Common stock, \$0.01 par value, authorized 50,000 shares, issued and outstanding 16,736 in 2001 and 15,957 in 2000.	167	160
Paid-in-capital.....	376,479	348,141
Distributions in excess of net income.....	(85,308)	(76,829)
Accumulated other comprehensive loss.....	(3,678)	(123)
	-----	-----
Total stockholders' equity.....	287,670	271,359
	-----	-----
Total liabilities and stockholders' equity.....	\$ 1,091,323	\$ 901,314
	=====	=====

The accompanying notes are an integral part of the financial statements.

**Chelsea Property Group, Inc.**  
**Condensed Consolidated Statements of Income**  
**for the Three and Nine Months Ended September 30, 2001 and 2000**  
**(Unaudited)**  
*(In thousands, except per share data)*

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2001	2000	2001	2000
	-----	-----	-----	-----
Revenues:				
Base rent.....	\$30,528	\$26,867	\$87,930	\$79,726
Percentage rent.....	4,051	4,063	9,851	9,812
Expense reimbursements.....	11,581	10,582	34,002	29,587
Other income.....	2,905	3,054	8,403	7,086
	-----	-----	-----	-----
Total revenues.....	49,065	44,566	140,186	126,211
	-----	-----	-----	-----
Expenses:				
Operating and maintenance.....	12,779	11,793	37,505	33,132
Depreciation and amortization.....	12,174	10,616	35,479	31,823
General and administrative.....	634	857	2,842	2,597
Other.....	461	1,159	1,924	2,324
	-----	-----	-----	-----
Total expenses.....	26,048	24,425	77,750	69,876
	-----	-----	-----	-----

Income before unconsolidated investments,

Edgar Filing: CHELSEA PROPERTY GROUP INC - Form 10-Q

interest expense and minority interest.....	23,017	20,141	62,436	56,335
Income from unconsolidated investments.....	3,953	2,199	10,509	2,644
Loss from Chelsea Interactive.....	(1,477)	(530)	(3,447)	(805)
Interest expense.....	(8,891)	(6,113)	(26,326)	(17,481)
	-----	-----	-----	-----
Income before minority interest.....	16,602	15,697	43,172	40,693
Minority interest.....	(3,717)	(3,756)	(10,213)	(10,157)
	-----	-----	-----	-----
Net income.....	12,885	11,941	32,959	30,536
Preferred dividend.....	(1,047)	(1,047)	(3,141)	(3,141)
	-----	-----	-----	-----
Net income to common shareholders.....	\$ 11,838	\$10,894	\$29,818	\$27,395
	=====	=====	=====	=====
Basic:				
Net income per common share.....	\$0.71	\$0.68	\$1.83	\$1.72
Weighted average common shares outstanding.....	16,568	15,942	16,269	15,937
Diluted:				
Net income per common share.....	\$0.69	\$0.67	\$1.78	\$1.70
Weighted average common shares and equivalents outstanding.....	17,160	16,214	16,767	16,130

The accompanying notes are an integral part of the financial statements.

**Chelsea Property Group, Inc.**  
**Condensed Consolidated Statements of Cash Flows**  
**for the Nine Months Ended September 30, 2001 and 2000**  
**(Unaudited)**  
*(In thousands)*

	2001	2000
	-----	-----
Cash flows from operating activities		
Net income.....	\$32,959	\$30,536
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization.....	35,479	31,823
Equity-in-earnings of unconsolidated investments in excess of distributions received.....	(1,956)	(1,788)
Loss from Chelsea Interactive.....	3,447	805
Minority interest in net income.....	10,213	10,157
Proceeds from non-compete receivable.....	4,600	4,600
Amortization of non-compete revenue.....	(3,852)	(3,852)
Additions to deferred lease costs.....	(391)	(210)
Other operating activities.....	(349)	208
Changes in assets and liabilities:		
Straight-line rent receivable.....	(1,181)	(1,048)
Other assets.....	4,670	5,355
Due from affiliates.....	(787)	(2,566)
Accounts payable and accrued expenses.....	(1,310)	2,166
	-----	-----
Net cash provided by operating activities.....	81,542	76,186
	-----	-----
Cash flows used in investing activities		
Additions to rental properties.....	(89,572)	(52,699)

## Edgar Filing: CHELSEA PROPERTY GROUP INC - Form 10-Q

Additions to investments in affiliates.....	(15,960)	(20,354)
Distributions from investments in affiliates in excess of earnings.....	5,090	-
Additions to deferred development costs.....	(6,074)	(91)
Proceeds from sale of center.....	-	3,372
Loans to related parties.....	(2,750)	-
Payments from related parties.....	1,725	-
	-----	-----
Net cash used in investing activities.....	(107,541)	(69,772)
	-----	-----
Cash flows used in financing activities		
Distributions.....	(40,208)	(39,001)
Debt proceeds.....	175,155	210,008
Repayments of debt.....	(134,750)	(151,250)
Additions to deferred financing costs.....	(2,054)	(3,201)
Net proceeds from sale of common stock.....	26,110	245
	-----	-----
Net cash provided by financing activities.....	24,253	16,801
	-----	-----
Net (decrease) increase in cash and cash equivalents.....	(1,746)	23,215
Cash and cash equivalents, beginning of period.....	18,036	8,862
	-----	-----
Cash and cash equivalents, end of period.....	\$16,290	\$32,077
	=====	=====

*The accompanying notes are an integral part of the financial statements.*

### Chelsea Property Group, Inc. Notes to Condensed Consolidated Financial Statements (Unaudited)

#### 1. Organization and Basis of Presentation

Chelsea Property Group, Inc., formerly Chelsea GCA Realty, Inc., (the "Company") is a self-administered and self-managed real estate investment trust ("REIT"). The Company is the managing general partner of CPG Partners, LP, formerly Chelsea GCA Realty Partnership, LP, (the "Operating Partnership" or "OP"), an operating partnership that has interests in and provides development, leasing, marketing and management services for upscale and fashion-oriented manufacturers' outlet centers (Premium Portfolio) and other retail centers. As of September 30, 2001, the Company had interests in 58 properties in 28 states and Japan (the "Properties") that contained approximately 12.5 million square feet of gross leasable area ("GLA"). The Company's premium portfolio included interests in 28 properties containing 8.2 million square feet of GLA near New York City, Los Angeles, Boston, Washington, D.C., San Francisco, Sacramento, Cleveland, Atlanta, Dallas, Portland (Oregon), Tokyo and Osaka, Japan, or at or near tourist destinations including Palm Springs, the Napa Valley, Orlando, and Honolulu. The Company's other retail portfolio was comprised of 30 centers acquired from a competitor on September 25, 2001 containing approximately 4.3 million square feet of GLA.

During 2000 the Company developed a technology-based e-commerce platform through an unconsolidated affiliate, Chelsea Interactive, Inc. ("Chelsea Interactive"). This platform provides fashion and other retail brands with their own customized direct-to-the-consumer Internet online stores, incorporating e-commerce design, development, fulfillment and customer services.

On September 25, 2001 the Company acquired 31 shopping centers (excluding Vegas Pointe Plaza which is to be repurchased in December 2001) from Konover Property Trust, Inc. and its affiliates ("Konover") pursuant to the provisions of an Agreement for Sale dated July 12, 2001. The centers contain a total of approximately 4.3 million square feet of gross leasable area. The total purchase price for the centers was approximately \$182.5 million, including

the assumption of approximately \$131 million of non-recourse mortgage debt . The accompanying financial statements include six days of operations from the acquired properties.

Virtually all of the Company's assets are held by, and all of its operations are conducted through, the OP. Due to the Company's ability, as the sole general partner, to exercise both financial and operational control over the OP, it is consolidated in the accompanying financial statements. All significant intercompany transactions and accounts have been eliminated in consolidation.

Common ownership of the OP as of September 30, 2001 was approximately as follows:

Company	84.1%	16,736,000	units
Unitholders	15.9%	3,155,000	units
	-----	-----	
Total	100.0%	19,891,000	

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for fair presentation have been included. Operating results for the three and nine month periods ended September 30, 2001 are not necessarily indicative of the results that may be expected for the year ending December 31, 2001. The balance sheet at December 31, 2000 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. These financial statements should be read in conjunction with the consolidated financial statements and accompanying notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2000.

In October 2001, the Financial Accounting Standards Board issued SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. SFAS No. 144 provides accounting guidance for financial accounting and reporting for the impairment or disposal of long-lived assets. SFAS No. 144 supersedes SFAS No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of*". It also supersedes the accounting and reporting of APB Opinion No. 50 "Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions" related to the disposal of a segment of a business. SFAS No. 144 is effective for fiscal years beginning after December 15, 2001. Management does not anticipate that its adoption will have a material effect on the financial position or results of operations of the Company.

Certain amounts in the prior year financial statements have been reclassified to conform to current year presentation.

## 2. Accounting Changes: Standards Implemented and Transition Adjustment

On January 1, 2001, the Company adopted SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities." SFAS No. 133, as amended, establishes accounting and reporting standards for derivative instruments. Specifically SFAS No. 133 requires an entity to recognize all derivatives as either assets or liabilities in the statement of financial position and to measure those instruments at fair value. Additionally, the fair value adjustments will affect either stockholders' equity or net income depending on whether the derivative instrument qualifies as a hedge for accounting purposes and, if so, the nature of the hedging activity.

The Company uses derivative instruments to protect against the risk of adverse price or interest rate movements on the

Edgar Filing: CHELSEA PROPERTY GROUP INC - Form 10-Q

value of certain firm commitments and liabilities or on future cash flows. The FASB continues to issue interpretive guidance that could require changes in the Company's application of the standard and adjustments to the transition amounts. SFAS No. 133 may increase or decrease reported net income and stockholders' equity prospectively, depending on future levels of interest rates and other variables affecting the fair values of derivative instruments and hedged items, but will have no effect on cash flows.

As of January 1, 2001, the adoption of the new standard resulted in derivative instruments reported on the balance sheet as assets of \$33,000 and an adjustment of \$33,000 to accumulated other comprehensive loss and minority interest.

### 3. Acquisitions

On September 25, 2001 the Company acquired 31 shopping centers (excluding Vegas Pointe Plaza which is to be repurchased in December 2001) from Konover Property Trust, Inc. and its affiliates ("Konover") pursuant to the provisions of an Agreement for Sale dated July 12, 2001. The centers contain a total of approximately 4.3 million square feet of gross leasable area. The total purchase price for the centers was approximately \$182.5 million, including the assumption of approximately \$131 million of non-recourse mortgage debt . The accompanying financial statements include six days of operations from the acquired properties.

Following is a list of the retail centers acquired from Konover:

<u>Name of Property</u>		<u>GLA</u>
Kittery Premium Outlets, formerly Factory Stores of America at Kittery, Kittery, ME	(1)	21,000
Factory Stores of America at:		
Vacaville, CA	(1)	447,000
Smithfield (I), NC	(1)	356,000
Smithfield (II), NC	(2), (3)	87,000
Branson, MO	(1)	287,000
North Bend, WA	(1)	223,000
Draper, UT	(1)	184,000
Georgetown, KY	(1)	177,000
LaMarque, TX	(1)	176,000
Mesa, AZ	(1)	167,000
Crossville, TN	(1)	151,000
Tri-Cities, TN	(2)	133,000
Iowa, LA	(1), (3)	131,000
Tupelo, MS	(2)	129,000
Tucson, AZ	(1)	127,000
Story City, IA	(1)	112,000
Boaz, AL	(1), (3)	105,000
West Frankfort, IL	(1)	91,000
Arcadia, LA	(1)	90,000
Nebraska City, NE	(1)	90,000
Lebanon, MO	(1)	86,000
Graceville, FL	(1)	84,000
Corsicana, TX	(1)	64,000
Hanson, KY	(1)	64,000
Hempstead, TX	(2)	64,000
Livingston, TX	(1)	64,000
Mineral Wells, TX	(1)	64,000
Union City, TN	(1)	60,000
Lake George, NY	(1)	44,000
Community Centers:		
-----		
MacGregor Village, Cary, NC	(1)	142,000

Edgar Filing: CHELSEA PROPERTY GROUP INC - Form 10-Q

Dare Center , Kill Devil, NC	(1), (3)	115,000
North Ridge, Raleigh, NC	(1)	165,000
		-----
Total		4,300,000
		=====

- (1) encumbered
- (2) unencumbered
- (3) subject to ground leases with termination dates ranging from 2007 to 2058. Certain ground leases allow for renewal terms from 4 to 30 years.

The following condensed pro forma (unaudited) information assumes the acquisition had occurred on January 1, 2000:

	Nine Months ended September 30,	
	2001	2000
	-----	-----
Total revenue.....	\$176,057	\$162,793
Net income to common shareholders.....	37,566	35,003
Earnings per share:		
Basic:		
Net income to common shareholders.....	\$2.25	\$2.12
Diluted:		
Net income to common shareholders.....	\$2.19	\$2.10

#### 4. Investments in Affiliates

The Company holds interests in domestic and international joint ventures including a 49% interest in F/C Acquisition Holdings, LLC ("F/C"), a 40% interest in Chelsea Japan Co., Ltd. ("Chelsea Japan"), a 50% interest in Orlando Premium Outlets with Simon Property Group, Inc. ("Simon") and minority interests in outlet centers and development projects in Europe operated by Value Retail PLC ("Value Retail"). The Company owns 40% of the common stock and 100% of the preferred stock of Chelsea Interactive.

Non-controlling investments are accounted for under the equity method. Income from unconsolidated investments and loss from Chelsea Interactive includes equity-in-earnings, management advisory, license and guarantee fees earned from these affiliates.

The following is a summary of investments in and amounts due from affiliates during the nine months ended September 30, 2001 (in thousands):

	F/C	Chelsea Japan	Simon	Chelsea Interact.	Value Retail	Other	Total
	-----	-----	-----	-----	-----	-----	-----
Balance 12/31/00...	\$33,114	\$ 6,245	\$15,922	\$ 29,899	\$4,742	\$ 1,707	\$ 91,629
Additional investment.....	1,528	561	-	9,447	318	(80)	11,774
Income (loss) from unconsolidated investments ..	4,580	2,388	3,567	(3,447)	165	(191)	7,062
Distributions and fees	(3,315)	(1,670)	(9,074)	-	-	-	(14,059)



Edgar Filing: CHELSEA PROPERTY GROUP INC - Form 10-Q

Other	325	1,038	(791)	217	(2)	787
Balance 9/30/01	\$ 36,232	\$ 8,562	\$ 9,624	\$ 36,116	\$ 5,225	\$ 1,434

The Company's share of income before depreciation, depreciation expense and income from unconsolidated investments for the three months ended September 30, 2001 and 2000 are as follows (in thousands):

	For the Three Months Ended September 30,					
	2001			2000		
	Inc. (loss) Before Depr.	Depr.	Inc. (loss) from Unconsol. Inv.	Inc. (loss) Before Depr.	Depr.	Inc. (loss) from Unconsol. Inv.
F/C	\$ 2,345	\$ 677	\$1,668	\$ -	\$ -	\$ -
Chelsea Japan	1,214	382	832	1,728	280	1,448
Simon	2,077	569	1,508	1,168	585	583
Other	(55)	-	(55)	168	-	168
Total	\$ 5,581	\$1,628	\$ 3,953	\$ 3,064	\$865	\$2,199
Chelsea Interactive	(\$ 580)	\$ 897	(\$ 1,477)	(\$450)	\$ 80	(\$530)

The Company's share of income before depreciation, depreciation expense and income from unconsolidated investments for the nine months ended September 30, 2001 and 2000 are as follows (in thousands):

	For the Nine Months Ended September 30,					
	2001			2000		
	Inc. (loss) Before Depr.	Depr.	Inc. (loss) from Unconsol. Inv.	Inc. (loss) Before Depr.	Depr.	Inc. (loss) from Unconsol. Inv.
F/C	\$6,574	\$1,994	\$4,580	\$ -	\$ -	\$ -
Chelsea Japan	3,389	1,001	2,388	1,728	280	1,448
Simon	5,272	1,705	3,567	1,502	585	917
Other	(26)	-	(26)	279	-	279
Total	\$15,209	\$4,700	\$10,509	\$3,509	\$865	\$2,644
Chelsea Interactive	(\$1,497)	\$1,950	(\$3,447)	(\$642)	\$163	(\$805)

## 5. Properties held for sale

As of September 30, 2001 properties held for sale represents the fair value, less estimated costs to sell of the following properties:

GLA	Carrying Value (in thousands)
-----	----------------------------------

Edgar Filing: CHELSEA PROPERTY GROUP INC - Form 10-Q

Mammoth Premium Outlets (1)	35,000	\$ 4,852
Factory Stores of America at LaMarque (2)	176,000	5,087
Vegas Pointe Plaza (2).....	230,000	2,537
Factory Stores of America at Tucson (2)	127,000	1,700
Factory Stores of America at West Frankfort (2)	91,000	560
	-----	-----
	659,000	\$ 14,736
	=====	=====

(1) On October 9, 2001 the Company sold Mammoth Premium Outlets for a net sales price approximating the carrying value.

(2) The Company has executed a purchase and sale agreement or is actively marketing these properties which were acquired in the Konover transaction. It is expected that each sale will take place within one year and that the sales proceeds will approximate carrying value.

For the three months and nine months ended September 30, 2001 and 2000 the centers held for sale accounted for less than 1% of Company revenues and net operating income.

## 6. Non-Compete Agreement

The Company recognized income from its non-compete agreement with The Mills Corporation of \$3.9 million during the nine months ended September 30, 2001 and 2000. Such amounts are included in other income.

## 7. Debt

The Company has a \$160 million senior unsecured bank line of credit (the "Senior Credit Facility") and has an annual right to request a one-year extension which may be granted at the option of the lenders. The Company's lenders have agreed to extend the Facility until March 30, 2004. The Senior Credit Facility bears interest on the outstanding balance, payable monthly, at a rate equal to the London Interbank Offered Rate ("LIBOR") plus 1.05% (3.72% at September 30, 2001) or the prime rate, at the Company's option. The LIBOR rate spread ranges from 0.85% to 1.25% depending on the Company's Senior Debt rating. A fee on the unused portion of the Senior Credit Facility is payable quarterly at rates ranging from 0.15% to 0.25% depending on the balance outstanding. At September 30, 2001, \$17.0 million was outstanding.

The Company also has a \$5 million term loan (the "Term Loan") which carries the same interest rate and maturity as the Senior Credit Facility.

A summary of the terms of the Unsecured Notes outstanding as of September 30, 2001 and December 31, 2000 is as follows:

	September 30, 2001	December 31, 2000	Effective Yield (1)
	-----	-----	-----
7.75% Unsecured Notes due January 2001.....	\$ -	\$99,987	7.85%
8.375% Unsecured Notes due August 2005.....	49,888	49,877	8.44%
7.25% Unsecured Notes due October 2007.....	124,801	124,776	7.29%
8.625% Unsecured Notes due August 2009.....	49,917	49,902	8.66%
8.25% Unsecured Notes due February 2011.....	148,633	-	8.40%
	-----	-----	-----
Total	\$373,239	\$324,542	
	=====	=====	

Edgar Filing: CHELSEA PROPERTY GROUP INC - Form 10-Q

(1) Including discount on the notes

A summary of the terms of the mortgage debt outstanding as of September 30, 2001 and December 31, 2000 and the related Net Book Value of the associated collateral ("NBV") and interest rate as of September 30, 2001 are as follows:

	September 30, 2001	December 31, 2000	Due Date	Interest Rate	NBV
REMIC Loan (1)	\$65,229	\$-	Dec. 2001	3.71%	\$105,045
Construction Loan (2)	27,148	21,526	Feb. 2003	4.36%	39,733
Bank Mortgage Loan (3)	68,500	69,250	April 2010	7.26%	74,591
Mortgage Loan (4)	72,622	-	March 2013	7.67%	75,049
	-----	-----			-----
	\$233,499	\$90,776			\$ 294,418
	=====	=====			=====

- (1) REMIC loans were assumed as part of the September 25, 2001 Konover acquisition and include Class A, B and C Loans that have a blended stated fixed interest rate of 7.85%. The Company received a \$0.5 million interest rate spread credit at closing reducing the effective annual interest rate to 3.71% until the loans are prepaid on December 3, 2001.
- (2) Construction Loan bears interest equal to LIBOR plus 1.375% or 4.36% at September 30, 2001.
- (3) Bank Mortgage Loan bears interest equal to LIBOR plus 1.50% (5.08% at September 30, 2001) or prime rate plus 1.0%. In December 2000, the Company entered into an interest swap agreement to hedge against unfavorable fluctuation in the LIBOR rates by fixing the interest rate at 7.26% until January 2006. As of September 30, 2001, the Company recognized net interest expense of \$0.6 million on the hedge which is included in interest expense. The loan terms call for quarterly principal amortization of \$0.3 million through April 2005 and \$0.5 million per quarter until maturity.
- (4) Mortgage Loan was assumed as part of the September 25, 2001 Konover acquisition. The stated interest rate of 9.1% was greater than that available to the Company in the public debt markets. Accordingly the Company recorded a \$6.9 million debt premium that will be amortized over the period of the loan and which reduces the effective interest rate to 7.67%. The loan calls for fixed monthly debt service payments of \$0.5 million for interest plus principal based on a 26-year amortization schedule. The Mortgage loan matures in March 2028 but can be prepaid in March 2013.

Interest and loan costs of approximately \$0.4 million and \$1.4 million were capitalized as development costs during the three months ended September 30, 2001 and 2000, respectively; and approximately \$1.5 million and \$3.6 million during the nine months ended September 30, 2001 and 2000, respectively.

## 8. Financial Instruments: Derivatives and Hedging

In the normal course of business, the Company is exposed to the effect of interest rate and foreign currency changes. The Company limits these risks by following established risk management policies and procedures including the use of derivatives. For interest rate exposures, derivatives are used primarily to align rate movements between interest rates associated with the Company's leasing income and other financial assets with interest rates on related debt, and manage the cost of borrowing obligations. For foreign currency exposures, derivatives are used primarily to align movements between currency rates to protect forecasted returns of fees to the U.S.

Edgar Filing: CHELSEA PROPERTY GROUP INC - Form 10-Q

The Company has a policy of only entering into contracts with major financial institutions based upon their credit ratings and other factors. When viewed in conjunction with the underlying and offsetting exposure that the derivatives are designed to hedge, the Company has not sustained a material loss from those instruments nor does it anticipate any material adverse effect on its net income or financial position in the future from the use of derivatives.

To manage interest rate and foreign currency risk, the Company may employ options, forwards, interest rate swaps, caps and floors or a combination thereof depending on the underlying exposure. The Company undertakes a variety of borrowings including lines of credit, medium- and long-term financings. To reduce overall interest cost, the Company may use interest rate instruments, typically interest rate swaps, to convert some or all of its variable rate debt to fixed rate debt, or even a portion of its fixed-rate debt to variable rate. Interest rate differentials that arise under these swap contracts are recognized in interest expense over the life of the contracts. The resulting cost of funds is usually lower than that which would have been available if debt with matching characteristics was issued directly.

The Company employs interest rate and foreign currency forwards or purchased options to hedge qualifying anticipated transactions. Gains and losses are deferred and recognized in net income in the same period that the underlying hedged transaction affects net income, expires or is otherwise terminated or assigned. As of September 30, 2001, there was \$4.3 million in deferred losses included in other comprehensive loss and minority interest.

The following table summarizes the notional values and fair values of the Company's derivative financial instruments.

Hedge Type	At September 30, 2001			
	Notional Value	Rate	Maturity	Fair Value
1) Swap, Cash Flow	\$68.5 mil	5.7625%	1/1/06	(\$4.3 mil)

The notional value and fair value of the swap provide an indication of the extent of the Company's involvement in financial derivative instruments at September 30, 2001 but do not represent exposure to credit, interest rate or market risks.

On September 30, 2001, the derivative instrument was reported at its fair value as other liabilities of \$4.3 million.

At March 31, 2001, the Company had a yen forward contract with a notional value of \$1.4 million and a fair value of \$0.04 million as a hedge against its yen denominated receivable. On June 21, 2001 the receivable and yen forward contract were settled and the Company received \$1.4 million.

Interest rate swaps that are designated as cash flow hedges hedge the future cash outflows on debt. Interest rate swaps that convert variable payments to fixed payments, interest rate caps, floors, collars, and forwards are cash flow hedges. The unrealized gains/losses in the fair value of cash flow hedges are reported on the balance sheet with a corresponding adjustment to accumulated other comprehensive loss to the extent they are offsetting and otherwise qualify in the period for cash flow hedge accounting. Over time, the unrealized gains and losses held in accumulated other comprehensive loss will be reclassified to earnings. This reclassification occurs over the same time period in which the hedge items affect earnings. Within the next twelve months, the Company expects to reclassify to earnings approximately \$1.0 million of the current balance held in accumulated other comprehensive loss and minority interest.

The Company hedges its exposure to the variability in future cash flows for forecasted transactions other than those associated with existing floating rate debt over a maximum period of 12 months. During the forecast period, unrealized gains and losses in the hedging instrument will be reported in accumulated other comprehensive loss and minority interest. Once the hedged transaction takes place, the hedge gains and losses will be reported in earnings during the same period in which the hedged item is recognized in earnings.

## 9. Stockholders' Equity

Following is a statement of stockholders' equity for the nine months ended September 30, 2001 (in thousands):

	Preferred Stock At Par Value	Common Stock At Par Value	Paid-in- Capital	Distrib. in Excess of Net Income	Accum. Other Comp. Loss	Total Stockho Equit
Balance December 31, 2000.....	\$10	\$160	\$348,141	(\$76,829)	(\$123)	\$271,
Net income.....	-	-	-	32,959		32,
Other comprehensive loss						
Foreign currency translation..	-	-	-		37	(3,
Interest rate swap.....	-	-	-		(3,592)	
Total comprehensive income.....						29,4
Preferred dividend.....	-	-	-	(3,141)		(3,1
Cash distributions declared						
(\$2.34 per common share).....	-	-	-	(38,297)		(38,2
Exercise of stock options.....	-	-	1,185	-	-	1,1
Shares issued (net of costs)....	-	5	24,836	-	-	24,8
Shares issued in exchange						
for units of the OP.....	-	2	2,233	-	-	2,2
Shares issued through Employee						
Stock						
Purchase Plan						
(net of costs).....	-	-	84	-	-	
Balance September 30, 2001.....	\$10	\$167	\$376,479	(\$85,308)	(\$3,678)	\$287,

On July 30, 2001, the Company completed the sale of 545,000 shares of common stock to an institutional investor at a net price of \$46 per share, yielding net proceeds of \$24.8 million that were used to partially fund the acquisition of the Konover assets and for general corporate purposes.

In October 2001, the Company sold two million shares of common stock at a price of \$45 per share, yielding net proceeds of \$85.0 million, which were used to repay borrowings under the Company's Senior Credit Facility and for general corporate purposes.

## 10. Dividends

On September 17, 2001, the Board of Directors of the Company declared a \$0.78 per share dividend to shareholders of record on September 28, 2001. The dividend, totaling \$13.0 million, was paid on October 15, 2001. The OP simultaneously paid a \$0.78 per unit cash distribution, totaling \$2.5 million, to its minority unitholders.

## 11. Income Taxes

At September 30, 2001, the Company was in compliance with all REIT requirements under Section 856(c) of the Internal Revenue code of 1986, as amended, and as such, was not subject to federal income taxes.

## 12. Net Income Per Common Share

Edgar Filing: CHELSEA PROPERTY GROUP INC - Form 10-Q

Basic earnings per common share is computed using the weighted average number of shares outstanding. Diluted earnings per common share is computed using the weighted average number of shares outstanding adjusted for the incremental shares attributed to outstanding options to purchase common stock of 0.6 million shares and 0.3 million shares for the three months ended September 30, 2001 and September 30, 2000 and 0.5 million and 0.2 million for the nine months ended September 30, 2001 and September 30, 2000 respectively.

The following table sets forth the computation of basic and diluted earnings per share for the periods indicated:

(In thousands, except per share amounts)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2001	2000	2001	2000
<b>Numerator</b>				
Numerator for basic and diluted earnings per share - net income to common shareholders.....	\$ 11,838	\$10,894	\$29,818	\$27,395
<b>Denominator</b>				
Denominator for basic earnings per share - weighted average shares.....	16,568	15,942	16,269	15,937
Effect of dilutive securities:				
Stock options.....	592	272	498	193
Denominator for diluted earnings per share - adjusted weighted-average shares and assumed conversions.....	17,160	16,214	16,767	16,130
Per share amounts:				
Net income - basic.....	\$0.71	\$0.68	\$1.83	\$1.72
Net income - diluted.....	\$0.69	\$0.67	\$1.78	\$1.70

### 13. Commitments and Contingencies

The 50/50 Orlando Premium Outlets ("OPO") joint venture with Simon has a \$66.0 million construction loan that is due in March 2002 and has two one year extensions. The loan bears interest at LIBOR plus 1.30% (4.65% at September 30, 2001) and is 10% guaranteed by each of the Company and Simon and as of September 30, 2001, \$58.4 million was outstanding. Changes in debt service coverage ratio provide for a guarantee ranging from 10% to 25% per guarantor and a LIBOR interest rate spread ranging from 130 to 150 basis points.

In October 1999, an equity investee of the Company entered into a 4 billion yen (approximately US \$33.5 million) line of credit guaranteed by the Company and OP to fund its share of Chelsea Japan's construction costs. The line of credit bears interest at yen LIBOR plus 1.35% (1.4106% at September 30, 2001) is due April 2002 and has two one year extensions. At September 30, 2001, 1.32 billion yen (approximately US \$11.0 million) was outstanding under the loan. In March 2000, Chelsea Japan entered into a 3.8 billion yen (approximately US \$31.8 million) loan with a bank to fund construction costs. As of September 30, 2001, the entire facility was outstanding and bears interest at 2.20%. The loan is secured by the two operating properties and is 40% guaranteed by the Company.

The Company has agreed under a standby facility to provide up to \$22.0 million in limited debt service guarantees for loans provided to Value Retail PLC and affiliates, to construct outlet centers in Europe. The term of the standby facility is three years and guarantees shall not be outstanding for longer than five years after project completion. As of September 30, 2001, the Company had provided limited debt service guarantees of approximately \$17.0 million to Value Retail PLC. In October 2001, the guarantee was increased to \$24.1 million until April 2002 at which time it will revert to \$22.0 million.

Accrued expenses and other liabilities include \$14.4 million and \$10.5 million at September 30, 2001 and December 31, 2000, respectively, related to a deferred unit incentive program with certain key officers to be paid in 2002.

Edgar Filing: CHELSEA PROPERTY GROUP INC - Form 10-Q

Included in other assets is \$2.8 million and \$7.4 million at September 30, 2001 and December 31, 2000, respectively, related to the present value of future payments to be received from The Mills Corporation under the Houston non-compete agreement.

The Company is not presently involved in any material litigation nor, to its knowledge, is any material litigation threatened against the Company or its properties, other than routine litigation arising in the ordinary course of business. Management believes the costs, if any, incurred by the Company related to any of this litigation will not materially affect the financial position, operating results or liquidity of the Company.

#### 14. Related Party Information

During the nine months ended September 30, 2001 the Company received a \$1.2 million payoff for one of the loans outstanding to unit holders and a \$0.5 million pay down on the other unit holder loan. On September 28, 2001 the Company advanced \$2.7 million to a unit holder to acquire approximately 10% non-voting equity interest in Chelsea Interactive. The unit holder issued a note that is secured by OP units, bears interest at a rate of LIBOR plus 200 basis points per annum, payable quarterly, and is due June 2004. At September 30, 2001 and 2000, \$3.2 million and \$2.2 million was due from the unit holders, respectively.

#### 15. Reportable Segments

The Company is principally engaged in the development, ownership, acquisition and operation of manufacturers' outlet centers and has determined that under SFAS No.131 "Disclosures About Segments of an Enterprise and Related Information" it has three reportable retail real estate segments: domestic premium, domestic other and international. The Company evaluates real estate performance and allocates resources based on Net Operating Income ("NOI"). The primary sources of revenue are generated from tenant base rents, percentage rents and reimbursement revenue. Operating expenses primarily consist of common area maintenance, real estate taxes and promotional expenses. The retail real estate business segments meet the quantitative threshold for determining reportable segments.

	Retail Domestic Premium	Retail Domestic Other	Retail International	Other (1)	Total
Three months ended September 30, 2001:					
NOI	\$36,921	\$447	\$1,657	\$1,556	\$40,581
Nine months ended September 30, 2001:					
NOI	\$106,571	\$447	\$ 4,682	\$1,056	\$112,756
Total assets	\$858,646	\$198,907	\$13,787	\$19,983	\$1,091,323

(1) Includes results of corporate assets and Chelsea Interactive.

The Company operated in one segment in 2000.

Following is a reconciliation of net operating income to net income for the three and nine months ended September 30, 2001 (in thousands):

<b>Three months</b>	<b>Nine months</b>
<b>Ended Sept. 30</b>	<b>Ended Sept. 30</b>

Edgar Filing: CHELSEA PROPERTY GROUP INC - Form 10-Q

	2001	2001
Segment NOI	\$40,581	\$112,756
Interest expense - consolidated	(8,891)	(26,326)
Interest expense - unconsol. inv.	(145)	(445)
Depreciation expense - consolidated	(12,174)	(35,479)
Depreciation expense - unconsol. Inv.	(2,525)	(6,650)
Income tax - unconsol. Inv.	(244)	(684)
Minority interest	(3,717)	(10,213)
Net income	\$12,885	\$32,959

## 16. Non-Cash Investing and Financing Activities

In connection with the acquisition of the 31 retail centers from Konover on September 25, 2001, the Company assumed \$131.0 million of nonrecourse first mortgage loans.

### Chelsea Property Group, Inc.

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

The following discussion should be read in conjunction with the accompanying unaudited condensed consolidated financial statements and notes thereto. These financial statements include all adjustments which, in the opinion of management, are necessary to reflect a fair statement of results for the interim periods presented, and all such adjustments are of a normal recurring nature.

#### General Overview

From October 1, 2000 to September 30, 2001, the Company grew by increasing rents at its operating centers, opening three new centers, expanding three centers and acquiring 35 centers. Increasing rents at comparable centers resulted in base rent growth of \$1.5 million. The opening of one wholly-owned new center and expansion of three wholly-owned centers increased base rent by \$2.5 million and \$3.5 million, respectively. The acquisition of 31 wholly-owned centers increased base rent by \$0.6 million. Income from unconsolidated investments increased by \$7.9 million primarily as a result of opening three new centers developed by joint ventures during 2000 and by acquiring a 49% interest in four centers through a joint venture in December 2000.

The Company operated gross leasable area ("GLA") at September 30, 2001 of 12.5 million square feet including wholly and partially-owned GLA compared to 6.0 million square feet at September 30, 2000 and had an interest in 58 manufacturers' outlet centers at September 30, 2001 compared to 21 at the end of the same quarter in the prior year. The Company's premium portfolio included interests in 28 properties containing 8.2 million square feet of GLA. The Company's other retail portfolio was comprised of 30 centers acquired from a competitor on September 25, 2001 containing approximately 4.3 million square feet of GLA. The accompanying financial statements include six days of operations from the acquired properties.

Net GLA added since October 1, 2000 is detailed as follows:

12 mos ended September 30, 2001	9 mos ended September 30, 2001	3 mos ended December 31, 2000
--	---	--

Changes in GLA (sf in 000's):



## Edgar Filing: CHELSEA PROPERTY GROUP INC - Form 10-Q

New centers developed:			
Allen Premium Outlets.....	206	-	206
Rinku Premium Outlets (40% owned).....	180	-	180
	-----	-----	-----
Total new centers.....	386	-	386
Centers expanded:			
Wrentham Premium Outlets.....	127	-	127
Leesburg Premium Outlets.....	104	-	104
Allen Premium Outlets.....	34	34	-
Other (net).....	1	-	1
	-----	-----	-----
Total centers expanded	266	34	232
Centers acquired:			
Gilroy Premium Outlets (49% owned).....	577	-	577
Lighthouse Place (49% owned).....	491	-	491
Waterloo Premium Outlets (49% owned).....	392	-	392
Kittery Premium Outlets I (49% owned).....	131	-	131
Kittery Premium Outlets, II (1).....	21	21	-
Other Retail Centers acquired from Konover (2).....	4,279	4,279	-
	-----	-----	-----
Total centers acquired	5,891	4,300	1,591
Net GLA added during the period.....	6,543	4,334	2,209
GLA at end of period.....	12,493	12,493	8,159

(1) Acquired in the September 25, 2001, Konover transaction and formerly known as Factory Stores of America at Kittery

(2) Excludes Vegas Pointe Plaza acquired as part of the September 25, 2001 acquisition, which is under option and management contracts and is to be repurchased on December 3, 2001.

### Results of Operations

*Comparison of the three months ended September 30, 2001 to the three months ended September 30, 2000.*

Income before minority interest increased \$0.9 million to \$16.6 million for the three months ended September 30, 2001 from \$15.7 million for the three months ended September 30, 2000. Increases in revenues, primarily the result of new center development, expansions, higher rents on releasing and renewals, the third quarter 2001 acquisition of the Konover properties and net earnings from unconsolidated investments that commenced operations in the second, third and fourth quarters of 2000 were partially offset by the loss from Chelsea Interactive and increases in operating, maintenance, depreciation and amortization and interest expenses.

Base rentals increased \$3.6 million, or 13.6%, to \$ 30.5 million for the three months ended September 30, 2001 from \$26.9 million for the three months ended September 30, 2000 due to the fourth quarter 2000 opening of Allen Premium Outlets, expansions and higher average rents on new leases and renewals and the third quarter 2001 acquisition of the Konover properties.

Percentage rents remained flat at \$4.1 million in 2001 and 2000.

Expense reimbursements, representing contractual recoveries from tenants of certain common area maintenance, operating, real estate tax, promotional and management expenses, increased \$ 1.0 million, or 9.4%, to \$11.6 million for the three months ended September 30, 2001 from \$10.6 million for the three months ended September 30, 2000, due to the recovery of operating and maintenance costs from increased GLA. The average recovery of reimbursable expenses was 90.6% in the third quarter of 2001, compared to 89.7% in the third quarter of 2000.

## Edgar Filing: CHELSEA PROPERTY GROUP INC - Form 10-Q

Other income decreased \$0.2 million to \$2.9 million for the three months ended September 30, 2001, from \$3.1 million for the three months ended September 30, 2000. The decrease is primarily due to the pad sale gains in the third quarter of 2000.

Operating and maintenance expenses increased \$1.0 million, or 8.4%, to \$12.8 million for the three months ended September 30, 2001 from \$11.8 million for the three months ended September 30, 2000. The increase was primarily due to costs related to expansions, the new center opening and higher insurance costs on the existing centers.

Depreciation and amortization expense increased \$1.6 million, or 14.7%, to \$12.2 million for the three months ended September 30, 2001 from \$10.6 million for the three months ended September 30, 2000. The increase was due to depreciation of expansions and the new center opening.

General and administrative expense decreased \$0.3 million to \$0.6 million for the three months ended September 30, 2001 from \$0.9 million for the three months ended September 30, 2000 primarily due to a lower accrual for deferred incentive compensation.

Other expenses decreased \$0.7 million to \$0.5 million for the three months ended September 30, 2001 from \$1.2 million for the three months ended September 30, 2000 primarily due to write-off of development costs related to inactive projects in the third quarter of 2000.

Income from unconsolidated investments increased \$1.8 million to \$4.0 million for the three months ended September 30, 2001 from \$2.2 million for the three months ended September 30, 2000. This resulted from equity-in-earnings and fees earned from the Company's unconsolidated investments that commenced operations during the fourth quarter of 2000 offset by one time consulting fees earned in the third quarter of 2000.

The loss from Chelsea Interactive increased \$1.0 million to \$1.5 million for the three months ended September 30, 2001 from \$0.5 million for the three months ended September 30, 2000 due to increased depreciation, selling, general, administrative and maintenance expenses.

Interest in excess of amounts capitalized increased \$2.8 million to \$8.9 million for the three months ended September 30, 2001 from \$6.1 million for the three months ended September 30, 2000 primarily due to higher debt balances and less construction activity.

### *Comparison of the nine months ended September 30, 2001 to the nine months ended September 30, 2000.*

Income before minority interest increased \$2.5 million to \$43.2 million for the nine months ended September 30, 2001 from \$40.7 million for the nine months ended September 30, 2000. Increases in revenues, primarily the result of new center development, expansions, higher rents on releasing and renewals, the third quarter 2001 acquisition of the Konover properties, and net earnings from unconsolidated investments that commenced operations in the second, third and fourth quarters of 2000 were partially offset by the loss from Chelsea Interactive and increases in operating, maintenance, depreciation and amortization and interest expenses.

Base rentals increased \$8.2 million, or 10.3%, to \$87.9 million for the nine months ended September 30, 2001 from \$79.7 million for the nine months ended September 30, 2000 due to the fourth quarter 2000 opening of Allen Premium Outlets, expansions and higher average rents on new leases and renewals and the third quarter 2001 acquisition of the Konover properties.

Percentage rents increased \$0.1 million or 1.0% to \$9.9 million for the nine months ended September 30, 2001 from \$9.8 million for the nine months ended September 30, 2000.

Expense reimbursements, representing contractual recoveries from tenants of certain common area maintenance, operating, real estate tax, promotional and management expenses, increased \$4.4 million, or 14.9%, to \$34.0 million for the nine months ended September 30, 2001 from \$29.6 million for the nine months ended September 30, 2000, due to the recovery of operating and maintenance costs from increased GLA. The average recovery of reimbursable expenses was 90.7% for the nine months ended September 30, 2001, compared to 89.3% for the nine months ended September 30, 2000.

Other income increased \$1.3 million to \$8.4 million for the nine months ended September 30, 2001, from \$7.1 million for the nine months ended September 30, 2000. The increase is primarily the result of increased interest income offset by higher pad sale gains for the nine months ended September 30, 2000.

Operating and maintenance expenses increased \$4.4 million, or 13.2%, to \$37.5 million for the nine months ended September 30, 2001 from \$33.1 million for the nine months ended September 30, 2000. The increase was primarily due to costs related to expansions, the new center opening and higher insurance costs on the existing centers.

Depreciation and amortization expense increased \$3.7 million, or 11.5%, to \$35.5 million for the nine months ended September 30, 2001 from \$31.8 million for the nine months ended September 30, 2000. The increase was due to depreciation of expansions and the new center opening.

General and administrative expense increased \$0.2 million to \$2.8 million for the nine months ended September 30, 2001 from \$2.6 million for the nine months ended September 30, 2000 primarily due to increased salaries.

Other expenses decreased \$0.4 million to \$1.9 million for the nine months ended September 30, 2001 from \$2.3 million for the nine months ended September 30, 2000. The decrease was primarily due to a 2000 write-off of deferred site expense offset by increases in bad debt in 2001.

Income from unconsolidated investments increased \$7.9 million to \$10.5 million for the nine months ended September 30, 2001 from \$2.6 million for the nine months ended September 30, 2000. This resulted from equity-in-earnings and fees earned from the Company's unconsolidated investments that commenced operations during the second half of 2000.

The loss from Chelsea Interactive increased \$2.6 million to \$3.4 million for the nine months ended September 30, 2001 from \$0.8 million for the nine months ended September 30, 2000 due to increased depreciation, administrative and maintenance expenses.

Interest in excess of amounts capitalized increased \$8.8 million to \$26.3 million for the nine months ended September 30, 2001 from \$17.5 million for the nine months ended September 30, 2000 primarily due to higher debt balances and lower construction balances.

### **Liquidity and Capital Resources**

The Company believes it has adequate financial resources to fund operating expenses, distributions, and planned development, construction and acquisition activities over the short-term, which is less than 12 months and the long-term, which is 12 months or more. Operating cash flow for the year ended December 31, 2000 of \$104.5 million is expected to increase with a full year of operations of the 2.9 million square feet of GLA added during 2000, scheduled openings of approximately 145,000 square feet in 2001, representing additional phases of Allen Premium Outlets and the third quarter 2001 acquisition of the 31 Konover properties. As of September 30, 2001, the Company has adequate funding sources to complete and open all current development projects, including those of its e-commerce affiliate, Chelsea Interactive, Inc. and pay off the assumed REMIC loan due in December 2001. This will be accomplished with available cash of \$16.3 million, net proceeds of \$85.0 million from the two million common shares issued in October 2001 and approximately \$143 million available under the Senior Credit Facility. The

Company also has the ability to access the public markets through its \$450 million debt shelf registration and its \$185 million equity shelf registration.

Operating cash flow is expected to provide sufficient funds for dividends and distributions in accordance with REIT federal income tax requirements. In addition, the Company anticipates retaining sufficient operating cash to fund re-tenanting and lease renewal tenant improvement costs, as well as capital expenditures to maintain the quality of its centers, and meet funding requirements for Chelsea Interactive.

Common distributions declared and recorded during the nine months ended September 30, 2001 were \$45.7 million, or \$2.34 per share or unit. The Company's dividend payout ratio as a percentage of net income before minority interest, depreciation and amortization (exclusive of amortization of deferred financing costs ("FFO")) was 61.3% for the nine months ended September 30, 2001. The Senior Credit Facility limits aggregate dividends and distributions to the lesser of (i) 90% of FFO on an annual basis or (ii) 100% of FFO for any two consecutive quarters.

In October 2001, the Company sold Mammoth Premium Outlets for a net sales price approximating the carrying value.

During the eighteen month period ended October 2001, the Company completed four new debt financing transactions totaling \$360 million, both secured and unsecured, and the sale of common stock totaling \$115 million. These transactions strengthened the Company's financial flexibility and liquidity by extending and sequencing debt maturities and significantly reducing floating interest rate exposure at favorable rates.

In October 2001, the Company sold two million shares of common stock at a price of \$45 per share, yielding net proceeds of \$85.0 million, which were used to repay borrowings under the Company's Senior Credit Facility and for general corporate purposes.

In July 2001, the Company completed the sale of 545,000 shares of common stock to an institutional investor at a net price of \$46 per share, yielding proceeds of \$24.8 million that were used to partially fund the acquisition of the Konover properties and for general corporate purposes.

On September 25, 2001, the Company acquired a portfolio of 31 retail centers from Konover for a purchase price of approximately \$182.5 million including the assumption of debt of approximately \$131.0 million. Proceeds from the 545,000 share common stock equity offering, cash on hand and \$17 million from the Senior Credit Facility were used to fund the balance of the purchase price.

In January 2001, the OP completed a \$150 million offering of 8.25% unsecured term notes due February 2011 (the "8.25% Notes"). The 8.25% Notes were priced to yield 8.396% to investors. Net proceeds from the offering were used to repay \$100 million of 7.75% unsecured notes due January 26, 2001, to repay all borrowings outstanding under the Company's Senior Credit Facility and for general corporate purposes.

Development activity as of September 30, 2001 includes an additional phase of Allen Premium Outlets, totaling 120,000 square feet scheduled to open during the fourth quarter 2001, the 71,000 square foot second phase of Rinku Premium Outlets, located outside Osaka, Japan, scheduled to open during the first quarter of 2002 and Chelsea Interactive. The Company is also in the predevelopment stage of projects outside Chicago, IL; Las Vegas, NV; and Seattle, WA that are expected to open in 2003 and beyond. These projects are under development and there can be no assurance that they will be completed or opened, or that there will not be delays in opening or completion. All current development activity is fully financed either through project specific secured construction financing, the yen denominated line of credit, available cash or through the Senior Credit Facility. The Company will seek to obtain permanent financing once the projects are completed and income has been stabilized.

The Company has minority interests ranging from 5% to 15% in several outlet centers and outlet development projects in Europe. Outlet centers, outside of London, England, Barcelona and Madrid, Spain and Paris, France are currently open and operated by Value Retail PLC and its affiliates. Two new European projects and expansions of the two existing centers are in various stages of development and are expected to open within the next two years. The Company's total investment in Europe as of September 30, 2001 was \$5.2 million. The Company has also agreed under a standby facility to provide up to \$22.0 million in limited debt service guarantees for loans provided to Value Retail PLC and affiliates, to construct outlet centers in Europe. The term of the standby facility is three years and guarantees shall not be outstanding for longer than five years after project completion. As of September 30, 2001, the Company had provided limited debt service guarantees of \$17.0 million for three projects. In October 2001 the guarantee was increased to \$24.1 million until April 2002 at which time it will revert to \$22.0 million.

To achieve planned growth and favorable returns in both the short and long term, the Company's financing strategy is to maintain a strong, flexible financial position by: (i) maintaining a conservative level of leverage; (ii) extending and sequencing debt maturity dates; (iii) managing exposure to floating interest rates; and (iv) maintaining liquidity. Management believes these strategies will enable the Company to access a broad array of capital sources, including bank or institutional borrowings and secured and unsecured debt and equity offerings, subject to market conditions.

Net cash provided by operating activities increased \$5.4 million for the nine months ended September 30, 2001 compared to the corresponding 2000 period, primarily due to increased GLA offset by a reduction of trade accounts payable. Net cash used in investing activities increased \$37.8 million for the nine months ended September 30, 2001 compared to the corresponding 2000 period, as a result of the acquisition of the Konover portfolio and increased development costs offset by decreased construction activity, increased distributions from joint venture investments, the equity requirements of Chelsea Interactive and proceeds from sale of a center in 2000. Net cash provided by financing activities increased by \$7.5 million for the nine months ended September 30, 2001 primarily due to the common stock offering proceeds in July 2001 and reduced debt repayment offset by reduced debt proceeds.

### Funds from Operations

Management believes that funds from operations ("FFO") should be considered in conjunction with net income, as presented in the statements of operations included elsewhere herein, to facilitate a clearer understanding of the operating results of the Company. The White Paper on Funds from Operations approved by the Board of Governors of NAREIT in October 1999 defines FFO as net income (loss) (computed in accordance with GAAP), excluding gains (or losses) from debt restructuring and sales of properties, plus real estate related depreciation and amortization and after adjustments for unconsolidated partnerships and joint ventures. The Company believes that FFO is helpful to investors as a measure of the performance of an equity REIT because, along with cash flow from operating activities, financing activities and investing activities, it provides investors with an indication of the ability of the Company to incur and service debt, to make capital expenditures and to fund other cash needs. The Company computes FFO in accordance with the current standards established by NAREIT which may not be comparable to FFO reported by other REITs that do not define the term in accordance with the current NAREIT definition or that interpret the current NAREIT definition differently than the Company. FFO does not represent cash generated from operating activities in accordance with GAAP and should not be considered as an alternative to net income (determined in accordance with GAAP) as an indication of the Company's financial performance or to cash flow from operating activities (determined in accordance with GAAP) as a measure of the Company's liquidity, nor is it indicative of funds available to fund the Company's cash needs, including its ability to make cash distributions.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2001	2000	2001	2000
Net income to common shareholders	\$11,838	\$10,894	\$29,818	\$27,395

## Edgar Filing: CHELSEA PROPERTY GROUP INC - Form 10-Q

Add (deduct) :				
Depreciation and amortization - wholly owned	12,174	10,616	35,479	31,823
Depreciation and amortization - joint ventures	1,628	865	4,700	865
Amortization of deferred financing costs and depreciation of non-rental real estate assets	(480)	(423)	(1,326)	(1,360)
Preferred units distribution	(1,462)	(1,462)	(4,386)	(4,386)
Minority interest	3,717	3,756	10,213	10,157
	-----	-----	-----	-----
FFO	\$27,415	\$24,246	\$74,498	\$64,494
	=====	=====	=====	=====
Average diluted shares/units outstanding	20,315	19,571	19,956	19,487
Dividends declared per share.....	\$0.78	\$0.75	\$ 2.34	\$2.25

### Recent Accounting Pronouncements

In October 2001, the Financial Accounting Standards Board issued SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. SFAS No. 144 provides accounting guidance for financial accounting and reporting for the impairment or disposal of long-lived assets. SFAS No. 144 supersedes SFAS No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of*". It also supersedes the accounting and reporting of APB Opinion No. 50 "Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions" related to the disposal of a segment of a business. SFAS No. 144 is effective for fiscal years beginning after December 15, 2001. Management does not anticipate that its adoption will have a material effect on the financial position or results of operations of the Company.

### Economic Conditions

Substantially all leases contain provisions, including escalations of base rents and percentage rentals calculated on gross sales, to mitigate the impact of inflation. Inflationary increases in common area maintenance and real estate tax expenses are substantially all reimbursed by tenants.

Virtually all tenants have met their lease obligations and the Company continues to attract and retain quality tenants. The Company intends to reduce operating and leasing risks by continually improving its tenant mix, rental rates and lease terms, and by pursuing contracts with creditworthy upscale and national brand-name tenants.

### Item 3. Quantitative and Qualitative Disclosures about Market Risk

The Company is exposed to changes in interest rates primarily from its floating rate debt arrangements. In December 2000, the Company implemented a policy to protect against interest rate and foreign exchange risk. The Company's primary strategy is to protect against this risk by using derivative transactions as appropriate to minimize the variability that floating rate interest and foreign currency fluctuations could have on cash flow.

In December 2000, a wholly-owned subsidiary of the Company entered into an interest rate swap agreement effective January 2, 2001 with a major financial institution for a notional amount of \$69.3 million amortizing to \$64.1 million to hedge against unfavorable fluctuations in the LIBOR rates of its secured mortgage loan facility. The hedge effectively produces a fixed interest rate of 7.2625% on the notional amount until January 1, 2006.

The derivative risk related to the settlement of this agreement is deemed to be immaterial as it involves a major financial institution.

At September 30, 2001 a hypothetical 100 basis point adverse move (increase) in US Treasury and LIBOR rates applied to unhedged debt would adversely affect the Company's annual interest cost by approximately \$0.5 million annually.

Edgar Filing: CHELSEA PROPERTY GROUP INC - Form 10-Q

Following is a summary of the Company's debt obligations at September 30, 2001 (in thousands):

	Expected Maturity Date						Total	Fair Value
	2001	2002	2003	2004	2005	Thereafter		
Fixed Rate Debt:	\$65,229	-	-	-	\$49,888	\$395,973	\$511,090	\$516,796
Average Interest Rate:	3.71%	-	-	-	8.38%	7.88%	7.92%	-
Variable Rate Debt:	-	-	\$27,148	\$22,035	-	\$68,500 (1)	\$117,683	\$117,683
				22,035				
Average Interest Rate:	-	-	4.36%	3.72%		5.56%	4.94%	-

(1) Mortgage hedged to produce a fixed interest rate of 7.26% until January 2006.

**Chelsea Property Group, Inc.**

**Part II. Other Information**

**Item 6. Exhibits and Reports on Form 8-K**

Current Report on Form 8-K, reporting under Items 2 and 7 on an event which occurred September 25, 2001.

**Chelsea Property Group, Inc.**

**Signatures**

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

CHELSEA PROPERTY GROUP, INC.

By: /s/ Michael J. Clarke  
 Michael J. Clarke  
 Chief Financial Officer

Date: November 14, 2001