American Assets Trust, Inc.
Form 10-Q
November 10, 2011
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2011 September 30, 2011

or

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

For the transition period from ______to ______

Commission file number: 001-35030

AMERICAN ASSETS TRUST, INC.

(Exact Name of Registrant as Specified in its Charter)

Maryland	**27-3338708**
(State of Organization)	**(IRS Employer Identification No.)**
11455 El Camino Real, Suite 200,	
San Diego, California	**92130**
(Address of Principal Executive Offices)	**(Zip Code)**

(858) 350-2600

(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. x Yes ¨ No

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post such files). x Yes ¨ No

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

Large Accelerated Filer	¨	Accelerated Filer	¨
Non-Accelerated Filer	x (Do not check if a smaller reporting company)	Smaller reporting company	¨

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

The number of Registrant s common shares outstanding on November 10, 2011 was 39,283,796.

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AMERICAN ASSETS TRUST, INC.

QUARTERLY REPORT ON FORM 10-Q

FOR THE QUARTER ENDED SEPTEMBER 30, 2011

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American Assets Trust, Inc.

Consolidated Balance Sheets

(In Thousands, Except Share Data)

	September 30, 2011 (unaudited)	December 31, 2010 (audited)
Assets		
Real estate, at cost		
Operating real estate	$ 1,653,329	$ 1,117,831
Construction in progress	4,285	925
Held for development	22,755	8,081
	1,680,369	1,126,837
Accumulated depreciation	(223,624)	(209,666)
Net real estate	1,456,745	917,171
Cash and cash equivalents	123,222	41,953
Restricted cash	8,760	4,481
Marketable securities	29,596	
Accounts receivable, net	6,525	1,564
Deferred rent receivables, net	22,792	19,486
Notes receivable from affiliate		21,769
Investment in real estate joint ventures		39,816
Prepaid expenses and other assets	77,121	43,718
Assets of discontinued operations		27,399
Total assets	$ 1,724,761	$ 1,117,357
Liabilities and equity		
Liabilities:		
Secured notes payable	$ 943,900	$ 828,685
Unsecured notes payable		38,013
Notes payable to affiliates		5,266
Accounts payable and accrued expenses	27,769	11,284
Security deposits payable	4,664	2,510
Other liabilities and deferred credits	57,955	38,846
Distributions in excess of earnings on real estate joint ventures		14,060
Liabilities of discontinued operations		23,572
Total liabilities	1,034,288	962,236
Commitments and contingencies (Note 11)		
Equity:		
Owners equity		121,874
American Assets Trust, Inc. stockholders equity		
Common stock $0.01 par value, 490,000,000 authorized, 39,283,796 outstanding at September 30, 2011	393	
Additional paid-in capital	652,932	
Accumulated dividends in excess of net income	(20,233)	
Total American Assets Trust, Inc. stockholders equity	633,092	

Noncontrolling interests		
Owners in consolidated real estate entities		33,247
Unitholders in the Operating Partnership	57,381	
	57,381	33,247
Total equity	690,473	155,121
Total liabilities and equity	$ 1,724,761	$ 1,117,357

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

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American Assets Trust, Inc.

Consolidated Statements of Operations

(Unaudited)

(In Thousands, Except Shares and Per Share Data)

	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Revenue:				
Rental income	$ 53,278	$ 33,903	$ 146,860	$ 88,213
Other property income	3,015	1,060	7,416	2,762
Total revenue	56,293	34,963	154,276	90,975
Expenses:				
Rental expenses	16,187	5,977	42,720	15,358
Real estate taxes	5,390	3,442	14,800	9,208
General and administrative	3,733	1,515	10,786	4,908
Depreciation and amortization	15,827	12,599	41,916	26,714
Total operating expenses	41,137	23,533	110,222	56,188
Operating income	15,156	11,430	44,054	34,787
Interest expense	(14,738)	(12,416)	(41,791)	(32,979)
Early extinguishment of debt			(25,867)	
Loan transfer and consent fees			(9,019)	
Gain on acquisition			46,371	4,297
Other income (expense), net	(108)	(251)	(179)	(1,167)
Income (loss) from continuing operations	310	(1,237)	13,569	4,938
Discontinued operations				
Income from discontinued operations	327	44	1,119	232
Gain on sale of real estate property	3,981		3,981	
Results from discontinued operations	4,308	44	5,100	232
Net income (loss)	4,618	(1,193)	18,669	5,170
Net income attributable to restricted shares	(132)		(350)	
Net loss attributable to Predecessor s noncontrolling interests in consolidated real estate entities		1,042	2,458	1,941
Net (income) loss attributable to Predecessor s controlled owners equity		151	(16,995)	(7,111)
Net income attributable to unitholders in the Operating Partnership	(1,434)		(1,209)	
Net income attributable to American Assets Trust, Inc. stockholders	$ 3,052	$	$ 2,573	$
Basic net income (loss) from continuing operations attributable to common stockholders per share	$ 0.00		$ (0.03)	
Basic net income from discontinued operations attributable to common stockholders per share	0.08		0.10	
Basic net income attributable to common stockholders per share	$ 0.08		$ 0.07	

Weighted average shares of common stock outstanding basic	38,655,084	36,106,397
Diluted net income (loss) from continuing operations attributable to common stockholders per share	$ 0.00	$ (0.03)
Diluted net income from discontinued operations attributable to common stockholders per share	0.08	0.10
Diluted net income attributable to common stockholders per share	$ 0.08	$ 0.07
Weighted average shares of common stock outstanding diluted	57,051,173	53,265,648
Dividends declared per common share	$ 0.21	$ 0.59

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

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American Assets Trust, Inc.

Consolidated Statements of Equity

(Unaudited)

(In Thousands, Except Share Data)

	American Assets Trust, Inc. Stockholders Equity							
	Common Shares							
	Shares	Amount	Additional Paid-in Capital	Accumulated dividends in excess of net income	Predecessor s Controlled Owners Equity	Noncontrolling Interests - Unitholders in the Operating Partnership	Predecessor s Noncontrolling Interests - Owners in Consolidated Entities	Total
Balance at December 31, 2010		$	$	$	$ 121,874	$	$ 33,247	$ 155,121
Net income (loss)				2,923	16,995	1,209	(2,458)	18,669
Distributions					(33,435)		(6,525)	(39,960)
Proceeds from sale of common stock, net	31,625,000	316	587,695					588,011
Cash paid to non-accredited investors							(6,075)	(6,075)
Issuance of restricted stock	630,663	6	(6)					
Forfeiture of restricted stock	(1,951)							
Issuance of common shares and units for acquisition of properties	262,486	3	6,081			27,770		33,854
Proceeds from private placement						5,410		5,410
Notes receivable from affiliate settled in common units						(21,797)		(21,797)
Notes payable to affiliates settled in common units						828		828
Dividends declared and paid				(23,156)		(10,854)		(34,010)
Stock-based compensation			1,902					1,902
Distribution of investment in joint venture not acquired					(9,084)		(2,396)	(11,480)
Exchange of owners equity for common stock and units	6,767,598	68	57,260		(96,350)	54,815	(15,793)	
Balance at September 30, 2011	39,283,796	$ 393	$ 652,932	$ (20,233)	$	$ 57,381	$	$ 690,473

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

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American Assets Trust, Inc.

Consolidated Statements of Cash Flows

(Unaudited)

(In Thousands)

	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
OPERATING ACTIVITIES		
Net income	$ 18,669	$ 5,170
Results from discontinued operations	(5,100)	(232)
Income from continuing operations	13,569	4,938
Adjustments to reconcile income from continuing operations to net cash provided by operating activities:		
Deferred rent revenue and amortization of lease intangibles	(1,639)	1,099
Depreciation and amortization	41,916	26,714
Amortization of debt issuance costs and debt fair value adjustments	2,924	418
Early extinguishment of debt	25,867	
Loan transfer and consent fees	9,019	
Gain on acquisition of controlling interests	(46,371)	(4,297)
Stock-based compensation expense	1,902	
Loss from real estate joint ventures	188	3,431
Distribution of earnings from real estate joint ventures		3,812
Other, net	1,586	497
Changes in operating assets and liabilities		
Change in restricted cash	(848)	(730)
Change in accounts receivable	(3,262)	(155)
Change in prepaid expenses and other assets	(590)	(1,725)
Change in accounts payable and accrued expenses	5,689	2,272
Change in security deposits and other liabilities	125	265
Net cash provided by operating activities of continuing operations	50,075	36,539
Net cash provided by operating activities of discontinued operations	1,748	1,055
Net cash provided by operating activities	51,823	37,594
INVESTING ACTIVITIES		
Acquisition of real estate, net of cash acquired	(227,309)	(19,762)
Capital expenditures	(5,871)	(3,355)
Change in restricted cash	(1,653)	16
Cash acquired from acquisition of controlling interests in real estate joint ventures	15,222	
Leasing commissions	(1,772)	(1,650)
Purchase of marketable securities	(33,103)	
Maturity of marketable securities	3,502	
Distribution of capital from real estate joint ventures		10,607
Issuance of notes receivable to affiliate		(800)
Net cash used in investing activities of continuing operations	(250,984)	(14,944)
Net cash provided by (used in) investing activities of discontinued operations	30,078	(444)

Net cash used in investing activities	(220,906)	(15,388)
FINANCING ACTIVITIES		
Issuance of secured notes payable	84,500	7,500
Repayment of secured notes payable	(263,106)	(10,647)
Defeasance costs on repayment of secured notes payable	(24,345)	
Loan transfer and consent fees paid	(8,350)	
Issuance of unsecured notes payable		23,000
Repayment of unsecured notes payable	(38,013)	(4,488)
Repayment of notes payable to affiliates	(19,279)	(1,778)
Debt issuance costs	(2,961)	(365)
Proceeds from issuance of common stock, net	596,541	
Proceeds from private placement of common units	5,410	
Dividends paid to common stock and unitholders	(34,010)	
Payments to nonaccredited investors	(6,075)	
Contributions from Predecessor s controlling interests		1,147
Distributions to Predecessor s controlling and non-controlling interests	(39,960)	(23,401)
Net cash provided by (used in) financing activities	250,352	(9,032)
Net increase in cash and cash equivalents	81,269	13,174
Cash and cash equivalents, beginning of period	41,953	24,189
Cash and cash equivalents, end of period	$ 123,222	$ 37,363

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

American Assets Trust, Inc.

Notes to Consolidated Financial Statements

September 30, 2011

(Unaudited)

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Business and Organization

American Assets Trust, Inc. (which may be referred to in these financial statements as the Company, we, us, or our) is a Maryland corporation formed on July 16, 2010 that did not have any operating activity until the consummation of our initial public offering (the Offering) and the related acquisition of certain assets of our Predecessor (as defined below) on January 19, 2011. The Company is the sole general partner of American Assets Trust, L.P., a Maryland limited partnership formed on July 16, 2010 (the Operating Partnership). The Company s operations are carried on through our Operating Partnership and its subsidiaries, including our taxable REIT subsidiary. Since the formation of our Operating Partnership, the Company has controlled our Operating Partnership as its general partner and has consolidated its assets, liabilities and results of operations.

In connection with the Offering, on January 19, 2011 the following transactions were completed:

- We issued a total of 31,625,000 shares of our common stock at $20.50 per share.
- We acquired, through a series of merger and contribution transactions (the Formation Transactions, as more fully described below), certain assets of our Predecessor and certain other entities. In exchange for such assets, the prior investors in such assets that were accredited investors were issued a total of 7,030,084 shares of our common stock and 18,145,039 common units of limited partnership interests in our Operating Partnership (common units), with an aggregate value of approximately $516.1 million, and non-accredited prior investors were paid a total of approximately $6.1 million in cash from the net proceeds of the Offering.
- We entered into a $250.0 million revolving credit facility (the credit facility) with an accordion feature to increase availability to $400.0 million under specified circumstances.
- We repaid $342.0 million of indebtedness (including $24.3 million of defeasance costs) and paid $10.8 million, net of $0.7 million prepaid by our Predecessor, for loan transfer and consent fees and credit facility origination fees from the net proceeds of the Offering.

The net proceeds from the Offering were approximately $594.6 million, net of $1.9 million of offering costs prepaid by our Predecessor, including the underwriters overallotment option which was exercised in full (after deducting the underwriting discount and commissions and expenses of the Offering and Formation Transactions). We contributed the net proceeds of the Offering to our Operating Partnership in exchange for common units.

Our Predecessor is not a legal entity but rather a combination of entities whose assets included entities owned and/or controlled by Ernest S. Rady and his affiliates, including the Ernest Rady Trust U/D/T March 13, 1983 (the Rady Trust), which in turn owned (1) controlling interests in entities owning 17 properties and the property management business of American Assets, Inc. (AAI) (the controlled entities), and (2) noncontrolling interests in entities owning four properties (the noncontrolled entities) (the assets described at (1) and (2) are the Acquired Assets, and do not include our Predecessor s noncontrolling 25% ownership interest in Novato FF Venture, LLC, the entity that owns the Fireman s Fund Headquarters in Novato, California). The Formation Transactions included the acquisition by our Operating Partnership of the (a) Acquired Assets, (b) the entities that own Waikiki Beach Walk (a mixed-use property consisting of a retail portion and a hotel portion) (the Waikiki Beach Walk entities) and (c) the entities that own Solana Beach Towne Centre and Solana Beach Corporate Centre (the Solana Beach Centre entities) (including our Predecessor s ownership interest in these entities).

The Formation Transactions enabled us to (1) consolidate the ownership of our property portfolio under our Operating Partnership, (2) succeed to the property management business of AAI, (3) facilitate the Offering, and (4) qualify as a real estate investment trust (a REIT) for U.S. federal income tax purposes commencing with the taxable year ending December 31, 2011. As a result of the Formation Transactions, we are a vertically integrated and self-administered REIT with approximately 110 employees providing substantial in-house expertise in asset management, property management, property development, leasing, tenant improvement construction, acquisitions, repositioning, redevelopment and financing.

American Assets Trust, Inc.

Notes to Consolidated Financial Statements (Continued)

September 30, 2011

(Unaudited)

We determined that our Predecessor was the acquirer for accounting purposes, and therefore the contribution or acquisition by merger of interests in the controlled entities was considered a transaction between entities under common control since our Executive Chairman, Ernest S. Rady or his affiliates, including the Rady Trust, owned the controlling interest in each of the entities comprising our Predecessor, which, in turn, owned a controlling interest in each of the controlled entities. As a result, the acquisition of interests in each of the controlled entities was recorded at our historical cost. The contribution or acquisition by merger of interests in certain of the noncontrolled entities, which include the Waikiki Beach Walk entities and the Solana Beach Centre entities (including our Predecessor s ownership interest in these noncontrolled entities), was accounted for as an acquisition under the acquisition method of accounting and recognized at the estimated fair value of acquired assets and assumed liabilities on the date of such contribution or acquisition.

Since these transactions occurred on January 19, 2011, the financial condition and results of operations for the entities acquired by us in connection with the Offering and related Formation Transactions are not included in certain historical financial statements. More specifically, our financial condition as of December 31, 2010 and results of operations for the nine months ended September 30, 2010 reflect the financial condition and results of operations for our Predecessor. Our financial condition as of September 30, 2011 and results of operations for the nine months ended September 30, 2011 reflect the financial condition and results of operation for our Predecessor together with the entities we acquired at the time of the Offering, namely, the Waikiki Beach Walk entities and the Solana Beach Centre entities, as well as First & Main, Lloyd District Portfolio and Solana Beach Highway 101, each acquired subsequent to the Offering. We have included the results of operations for the acquired entities in our consolidated statements of operations from the date of acquisition.

Prior to the Offering, the Predecessor s combined financial statements included investments in certain real estate joint ventures in which Ernest Rady and his affiliates had significant influence, but not control, over major decisions, including the decision to sell or refinance the properties. These investments, which represent non-controlling 25% to 80% ownership interests, were accounted for using the equity method of accounting. The Predecessor s investments in certain real estate joint ventures for which it had unilateral control, evidenced by the ability to make all major decisions, such as the acquisition, sale or refinancing of the property without approval of the minority party, were combined in these financial statements as they were under the common control of Ernest Rady and his affiliates.

As of September 30, 2011, we owned or had a controlling interest in 21 office, retail, multifamily and mixed-use operating properties, the operations of which we consolidate. Additionally, as of September 30, 2011, we owned land at five of our properties that we classify as held for development. A summary of the properties owned by us is as follows:

Retail

Carmel Country Plaza

Carmel Mountain Plaza

South Bay Marketplace

Rancho Carmel Plaza

Lomas Santa Fe Plaza

Solana Beach Towne Centre

Del Monte Center

The Shops at Kalakaua

Waikele Center

Alamo Quarry Market

Office

Torrey Reserve Campus

Solana Beach Corporate Centre

160 King Street

The Landmark at One Market

First & Main

Lloyd District Portfolio

Multifamily

Loma Palisades

Imperial Beach Gardens

Mariner s Point

Santa Fe Park RV Resort

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American Assets Trust, Inc.

Notes to Consolidated Financial Statements (Continued)

September 30, 2011

(Unaudited)

Mixed-Use

Waikiki Beach Walk Retail and Hotel

Held for Development

Solana Beach Corporate Centre Land

Solana Beach Highway 101 Land

Sorrento Pointe Land

Torrey Reserve Land

Lloyd District Portfolio Land

Basis of Presentation

Our consolidated financial statements include the accounts of the Company, our Operating Partnership and our subsidiaries. The equity interests of other investors in our Operating Partnership are reflected as noncontrolling interests. The combined financial statements of our Predecessor include the accounts of our Predecessor and all entities in which our Predecessor had a controlling interest. When our Predecessor was the general partner or managing member of a limited partnership or limited liability company, as the case may be, our Predecessor was presumed to control the limited partnership or limited liability company unless the limited partners or non-managing members possessed or possess either (1) the substantive ability to dissolve the partnership or otherwise remove our Predecessor as the general partner or managing member without cause (commonly referred to as kick-out rights), or (2) the right to participate in substantive operating and financial decisions of the limited partnership or limited liability company that were expected to be made in the course of their business. The equity interests of other investors were reflected as noncontrolling interests. Our Predecessor accounted for its interests in joint ventures which it did not control using the equity method of accounting.

All significant intercompany transactions and balances are eliminated in consolidation.

In August 2011, we sold Valencia Corporate Center. We have reclassified our financial statements for all periods prior to the sale to reflect Valencia Corporate Center as discontinued operations. Unless noted otherwise, discussions in these notes pertain to our continuing operations.

The accompanying consolidated financial statements of the Company have been prepared in accordance with the rules applicable to Form 10-Q and include all information and footnotes required for interim financial statement presentation, but do not include all disclosures required under accounting principles generally accepted in the United States (GAAP) for annual financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments, except as otherwise noted) considered necessary for a fair presentation have been included.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that in certain circumstances affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities, and revenues and expenses. These estimates are prepared using management s best judgment, after considering past, current and expected events and economic conditions. Actual results could differ from these estimates.

Consolidated Statements of Cash Flows Supplemental Disclosures

The following table provides supplemental disclosures related to the Consolidated Statements of Cash Flows (in thousands):

	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Supplemental cash flow information		
Cash paid for interest	$ 39,158	$ 33,131
Supplemental schedule of noncash investing and financing activities		
Accounts payable and accrued liabilities for property under development	$ 1,525	$ (103)
Assumption of debt upon acquisition (Note 2)	$ 268,008	$ 133,000
Assumption of notes to affiliates upon acquisition (Note 2)	$ 14,824	$
Acquisition of working capital deficit, net of cash (Note 2)	$ (4,175)	$ (1,972)
Distribution of investment in joint venture not acquired	$ 11,480	$
Issuance of common shares and units for acquisition of properties	$ 33,854	$

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American Assets Trust, Inc.

Notes to Consolidated Financial Statements (Continued)

September 30, 2011

(Unaudited)

	Nine Months Ended September 30, 2011	2010
Notes receivable from affiliate settled in common units	$ 21,797	$
Notes payable to affiliates settled in common units	$ 828	$
Reduction to capital for prepaid Offering costs	$ 1,974	$
Transfer taxes accrued at time of Offering	$ 6,556	$

Offering Costs

In connection with the Offering, affiliates incurred legal, accounting and related costs, which were assumed or reimbursed by the Company upon the consummation of the Offering and such costs were deducted from the gross proceeds of the Offering.

Revenue Recognition and Accounts Receivable

Our leases with tenants are classified as operating leases. Substantially all such leases contain fixed rent escalations which occur at specified times during the term of the lease. Base rents are recognized on a straight-line basis from when the tenant controls the space through the term of the related lease, net of valuation adjustments, based on management s assessment of credit, collection and other business risks. Percentage rents, which represent additional rents based upon the level of sales achieved by certain tenants, are recognized at the end of the lease year or earlier if we have determined the required sales level is achieved and the percentage rents are collectible. Real estate tax and other cost reimbursements are recognized on an accrual basis over the periods in which the related expenditures are incurred. Other property income includes parking income, general excise tax billed to tenants and fees charged to tenants at our multifamily properties. Other property income is recognized when earned. For a tenant to terminate its lease agreement prior to the end of the agreed term, we may require that they pay a fee to cancel the lease agreement. Lease termination fees for which the tenant has relinquished control of the space are generally recognized on the termination date. When a lease is terminated early but the tenant continues to control the space under a modified lease agreement, the lease termination fee is generally recognized evenly over the remaining term of the modified lease agreement.

We recognize revenue on the hotel portion of our mixed-use property from the rental of hotel rooms and guest services when the rooms are occupied and services have been provided. Food and beverage sales are recognized when the customer has been served or at the time the transaction occurs. Revenue from room rental is included in rental revenue on the statement of operations. Revenue from other sales and services provided is included in other property income on the statement of operations.

We make estimates of the collectibility of our accounts receivable related to minimum rents, straight-line rents, expense reimbursements and other revenue. Accounts receivable and deferred rent receivable are carried net of this allowance for doubtful accounts. We generally do not require collateral or other security from our tenants, other than letters of credit or security deposits. Our determination as to the collectibility of accounts receivable and correspondingly, the adequacy of this allowance, is based primarily upon evaluations of individual receivables, current economic conditions, historical experience and other relevant factors. The allowance for doubtful accounts is increased or decreased through bad debt expense. In some cases, primarily relating to straight-line rents, the collection of these amounts extends beyond one year. Our experience relative to unbilled straight-line rents is that a portion of the amounts otherwise recognizable as revenue is never billed to or collected from tenants due to early lease terminations, lease modifications, bankruptcies and other factors. Accordingly, the extended collection period for straight-line rents along with our evaluation of tenant credit risk may result in the nonrecognition of a portion of straight-line rental income until the collection of such income is reasonably assured. If our evaluation of tenant credit risk changes indicating more straight-line revenue is reasonably collectible than previously estimated and realized, the additional straight-line rental income is recognized as revenue. If our evaluation of tenant credit risk changes indicating a portion of realized straight-line rental income is no longer collectible, a reserve and bad debt expense is recorded. At September 30, 2011 and December 31, 2010, our allowance for doubtful accounts was $1.8 million and $1.0 million, respectively.

We recognize gains on sales of properties upon the closing of the transaction with the purchaser. Gains on properties sold are recognized using the full accrual method when (1) the collectibility of the sales price is reasonably assured, (2) we are not obligated to perform significant activities after the sale, (3) the initial investment from the buyer is sufficient and (4) other profit recognition criteria have been satisfied. Gains on sales of properties may be deferred in whole or in part until the requirements for gain recognition have been met.

American Assets Trust, Inc.

Notes to Consolidated Financial Statements (Continued)

September 30, 2011

(Unaudited)

We receive various fee income from unconsolidated real estate joint ventures including property management fees, construction management fees, acquisition and disposition fees, leasing fees, asset management fees and financing fees. Fee income is recorded as earned in accordance with the respective fee agreement. Profit from these fees, if any, is eliminated to the extent of our ownership interest in these entities. Subsequent to the Formations Transactions and the acquisition of the outside interests in unconsolidated joint ventures, we no longer earn fee revenue (Note 15).

Real Estate

Land, buildings and improvements are recorded at cost. Depreciation is computed using the straight-line method. Estimated useful lives range generally from 30 years to a maximum of 40 years on buildings and major improvements. Minor improvements, furniture and equipment are capitalized and depreciated over useful lives ranging from 3 years to 15 years. Maintenance and repairs that do not improve or extend the useful lives of the related assets are charged to operations as incurred. Tenant improvements are capitalized and depreciated over the life of the related lease or their estimated useful life, whichever is shorter. If a tenant vacates its space prior to the contractual termination of its lease, the undepreciated balance of any tenant improvements are written off if they are replaced or have no future value. For the nine months ended September 30, 2011 and 2010, real estate depreciation expense was $30.4 million and $22.8 million, respectively.

Acquisitions of properties are accounted for in accordance with the authoritative accounting guidance on acquisitions and business combinations. Our methodology of allocating the cost of acquisitions to assets acquired and liabilities assumed is based on estimated fair values, replacement cost and appraised values. When we acquire operating real estate properties, the purchase price is allocated to land and buildings, intangibles such as in-place leases, and to current assets and liabilities acquired, if any. Such valuations include a consideration of the non-cancellable terms of the respective leases as well as any applicable renewal periods. The fair values associated with below market renewal options are determined based on a review of several qualitative and quantitative factors on a lease-by-lease basis at acquisition to determine whether it is probable that the tenant would exercise its option to renew the lease agreement. These factors include: (1) the type of tenant in relation to the property it occupies, (2) the quality of the tenant, including the tenant s long term business prospects and (3) whether the fixed rate renewal option was sufficiently lower than the fair rental of the property at the date the option becomes exercisable such that it would appear to be reasonably assured that the tenant would exercise the option to renew. The value allocated to in-place leases is amortized over the related lease term and reflected as depreciation and amortization in the statement of operations. The value of above and below market leases associated with the original noncancelable lease terms are amortized to rental income over the terms of the respective non-cancelable lease periods and are reflected as either an increase (for below market leases) or a decrease (for above market leases) to rental income in the statement of operations. The value of the leases associated with below market lease renewal options that are likely to be exercised are amortized to rental income over the respective renewal periods. If a tenant vacates its space prior to contractual termination of its lease or the lease is not renewed, the unamortized balance of any in-place lease value is written off to rental income and amortization expense. Acquisition-related expenses are expensed in the period incurred.

We capitalize certain costs related to the development and redevelopment of real estate including pre-construction costs, real estate taxes, insurance and construction costs and salaries and related costs of personnel directly involved. Additionally, we capitalize interest costs related to development and significant redevelopment activities. Capitalization of these costs begins when the activities and related expenditures commence and cease when the project is substantially complete and ready for its intended use, at which time the project is placed in service and depreciation commences. Additionally, we make estimates as to the probability of certain development and redevelopment projects being completed. If we determine that the completion of development or redevelopment is no longer probable, we expense all capitalized costs which are not recoverable.

Impairment of Long Lived Assets

We review for impairment on a property by property basis. Impairment is recognized on properties held for use when the expected undiscounted cash flows for a property are less than its carrying amount at which time the property is written-down to fair value. Properties held for sale are recorded at the lower of the carrying amount or the expected sales price less costs to sell. The sale or disposal of a component of an entity is treated as discontinued operations. The operating properties sold by us typically meet the definition of a component of an entity and as such the revenues and expenses associated with sold properties are reclassified to discontinued operations for all periods presented.

Financial Instruments

The estimated fair values of financial instruments are determined using available market information and appropriate valuation methods. Considerable judgment is necessary to interpret market data and develop estimated fair values. The use of different market

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assumptions or estimation methods may have a material effect on the estimated fair value amounts. Accordingly, estimated fair values are not necessarily indicative of the amounts that could be realized in current market exchanges.

Cash and Cash Equivalents

We define cash and cash equivalents as cash on hand, demand deposits with financial institutions and short term liquid investments with an initial maturity of less than three months. Cash balances in individual banks may exceed the federally insured limit of $250,000 by the Federal Deposit Insurance Corporation. No losses have been experienced related to such accounts.

Restricted Cash

Restricted cash consists of amounts held by lenders to provide for future real estate tax expenditures, insurance expenditures and reserves for capital improvements. Activity for accounts related to real estate tax and insurance expenditures is classified as operating activities in the statement of cash flows. Changes in reserves for capital improvements are classified as investing activities in the statement of cash flows.

Marketable Securities

Our portfolio of marketable securities is comprised of debt securities that are classified as trading. Trading securities are presented on our consolidated balance sheets at fair value at the end of each reporting period. Gains and losses resulting from the mark-to-market of these securities are recognized as unrealized gains or losses in income.

Prepaid Expenses and Other Assets

Prepaid expenses and other assets consist primarily of lease costs, lease incentives, acquired in-place leases, acquired above market leases and debt issuance costs. Capitalized lease costs are direct costs incurred which were essential to originate a lease and would not have been incurred had the leasing transaction not taken place and include third party commissions and internal salaries and personnel costs related to obtaining a lease. Capitalized lease costs are amortized over the life of the related lease and included in depreciation and amortization expense on the statement of operations. If a tenant vacates its space prior to the contractual termination of its lease, the unamortized balance of any lease costs are written off. We view these lease costs as part of the up-front initial investment we made in order to generate a long-term cash inflow. Therefore, we classify cash outflows for lease costs as an investing activity in our consolidated statements of cash flows.

Costs related to the issuance of debt instruments are capitalized and are amortized as interest expense over the estimated life of the related issue using the straight-line method which approximates the effective interest method. If a debt instrument is paid off prior to its original maturity date, the unamortized balance of debt issuance costs are written off to interest expense or, if significant, included in early extinguishment of debt. For the nine months ended September 30, 2011, $0.6 million in debt issuance costs were written off and included in early extinguishment of debt.

Variable Interest Entities

Certain entities that do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties or in which equity investors do not have the characteristics of a controlling financial interest qualify as variable interest entities (VIEs). VIEs are required to be consolidated by their primary beneficiary. The primary beneficiary of a VIE is the party that has a controlling interest in the VIE. Identifying the party with the controlling interest requires a focus on which entity has the power to direct the activities of the VIE that most significantly impact the VIE s economic performance and (1) the obligation to absorb the expected losses of the VIE or (2) the right to receive the benefits from the VIE. We have evaluated our investments in certain joint ventures and determined that these joint ventures do not meet the requirements of a VIE and, therefore, consolidation of these ventures is not required. These investments are accounted for using the equity method. Our investment balances in our real estate joint ventures are presented separately in our consolidated balance sheets.

Investments in Real Estate Joint Ventures

We analyze our investments in real estate joint ventures under applicable guidance to determine if the venture is considered a VIE and would require consolidation. To the extent that the ventures do not qualify as VIEs, we further assess the venture to determine whether a general partner, or the general partners as a group, controls a limited partnership or similar entity when the limited partners have certain rights in order to determine whether consolidation is required.

We consolidate those ventures that are considered to be VIEs where we are the primary beneficiary. For non-VIEs, the Predecessor combined those ventures that Ernest Rady or the Rady Trust controlled through majority ownership interests or where the

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Predecessor was the managing member and the partner did not have substantive participating rights. Control is further demonstrated by the ability of the general partner to manage day-to-day operations, refinance debt and sell the assets of the venture without the consent of the limited partner and inability of the limited partner to replace the general partner. We use the equity method of accounting for those ventures where we do not have control over operating and financial policies. Under the equity method of accounting, the investment in each venture is included on our balance sheet; however, the assets and liabilities of the ventures for which we use the equity method are not included in the balance sheet. The investment is adjusted for contributions, distributions and our proportionate share of the net earnings or losses of each respective venture.

We assess whether there has been impairment in the value of our investments in real estate joint ventures periodically. An impairment charge is recorded when events or changes in circumstances indicate that a decline in the fair value below the carrying value has occurred and such decline is other-than-temporary. The ultimate realization of the investments in unconsolidated real estate joint ventures is dependent on a number of factors, including the performance of the investments and market conditions.

Notes Receivable from Affiliate

Certain entities made loans to affiliates in order to attain a higher return on excess cash balances, and these loans were classified as notes receivable from affiliate at December 31, 2010. The notes bore interest at LIBOR and were to be repaid upon demand. The notes were settled as part of the Formation Transactions.

Notes Payable to Affiliates

Owners of certain entities made loans to the entities, and these loans were classified as notes payable to affiliates at December 31, 2010. The notes bore interest at 10% and matured in 2013. The notes were repaid using proceeds from the Offering or were settled as part of the Formation Transactions.

Stock-Based Compensation

We grant stock-based compensation awards to our employees and directors typically in the form of restricted shares of common stock, options to purchase common stock and/or shares of common stock. We measure stock-based compensation expense based on the fair value of the award on the grant date and recognize the expense ratably over the vesting period.

Deferred Compensation

Our Operating Partnership has adopted the American Assets Trust Executive Deferral Plan V (EDP V) and the American Assets Trust Executive Deferral Plan VI (EDP VI). These plans were adopted by our Operating Partnership as successor plans to those deferred compensation plans maintained by AAI in which certain employees of AAI, who were transferred to us in connection with the Offering (the Transferred Participants), participated prior to the Offering. EDP V and EDP VI contain substantially the same terms and conditions as these predecessor plans. AAI transferred to our Operating Partnership the Transferred Participants account balances under the predecessor plans. These transferred account balances represent amounts deferred by the Transferred Participants prior to the Offering while they were employed by AAI.

At the time eligible participants defer compensation, we record compensation cost and a corresponding deferred compensation plan liability, which is included in other liabilities and deferred credits on our consolidated balance sheets. This liability is adjusted to fair value at the end of each accounting period based on the performance of the benchmark funds selected by each participant, and the impact of adjusting the liability to fair value is recorded as an increase or decrease to compensation cost.

Income Taxes

Prior to the Offering, we were comprised primarily of limited partnerships and limited liability companies. Under applicable federal and state income tax rules, the allocated share of net income or loss from the limited partnerships and limited liability companies was reportable in the income tax returns of the respective partners and members.

Subsequent to the Offering, we intend to elect to be taxed as a REIT under the Internal Revenue Code of 1986, as amended (the Code) commencing with the taxable year ending December 31, 2011. To qualify as a REIT, we are required to distribute at least 90% of our REIT taxable income to our stockholders and meet the various other requirements imposed by the Code relating to such matters as operating results, asset holdings, distribution levels and diversity of stock ownership. Provided we qualify for taxation as a REIT, we are generally not subject to corporate level income tax on the earnings distributed currently to our stockholders that we derive from our REIT qualifying activities. If we fail to qualify as a REIT in any taxable year, and are unable to avail ourselves of certain savings provisions set forth in the Code, all of our taxable income would be subject to federal income tax at regular corporate rates, including any applicable alternative minimum tax.

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We, together with one of our subsidiaries, will elect to treat such subsidiary as a taxable REIT subsidiary (a TRS) for federal income tax purposes. Certain activities that we undertake must be conducted by a TRS, such as non-customary services for our tenants, and holding assets that we cannot hold directly. A TRS is subject to federal and state income taxes.

Segment Information

Segment information is prepared on the same basis that our management reviews information for operational decision-making purposes. We operate in four business segments: (1) the acquisition, redevelopment, ownership and management of retail real estate, (2) the acquisition, redevelopment, ownership and management of office real estate, (3) the acquisition, redevelopment, ownership and management of multifamily real estate and (4) the acquisition, redevelopment, ownership and management of mixed-use real estate. The products for our retail segment primarily include rental of retail space and other tenant services, including tenant reimbursements, parking and storage space rental. The products for our office segment primarily include rental of office space and other tenant services, including tenant reimbursements, parking and storage space rental. The products for our multifamily segment include rental of apartments and other tenant services. The products of our mixed-use segment include rental of retail space and other tenant services, including tenant reimbursements, parking and storage space rental and operation of a 369-room all-suite hotel.

Reclassifications

Certain items in the consolidated financial statements for prior periods have been reclassified to conform to current classifications.

Recent Accounting Pronouncements

In December 2010, the Financial Accounting Standards Board (FASB) issued ASU No. 2010-29, *Disclosure of Supplementary Pro Forma Information for Business Combinations* (ASU 2010-29), which amended ASC Topic 805, *Business Combinations* (ASC 805). The objective of this guidance is to eliminate diversity in the interpretation of pro forma revenue and earnings disclosures requirements for business combinations. The guidance specifies that if a public entity presents comparative financial statements, the entity should disclose revenue and earnings of the combined entity as though the business combination(s) that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only. The guidance also expands the supplemental pro forma disclosures under ASC 805 to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination(s) included in the reported pro forma revenue and earnings. ASU 2010-29 is effective for business combinations for which the acquisition date occurs following the first annual reporting period which commences after December 15, 2010. The guidance is required in interim and annual reporting periods. Our adoption of this guidance effective January 1, 2011 did not have a material effect on our consolidated financial statements.

In May 2011, the FASB issued ASU No. 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs* (ASU 2011-04), which amended ASC Topic 820, *Fair Value Measurement.* ASU 2011-04 clarifies the application of certain existing fair value measurement guidance and expands the disclosures for fair value measurements that are estimated using significant unobservable (Level 3) inputs. ASU 2011-04 is effective for annual and interim reporting periods beginning on or after December 15, 2011. The new guidance is to be adopted prospectively and early adoption is not permitted. We do not believe that adoption of ASU 2011-04 will have a significant impact on our financial position, results of operations or cash flows.

In June 2011, the FASB issued ASU No. 2011-05, *Presentation of Comprehensive Income* (ASU 2011-05), which amended ASC Topic 220, *Comprehensive Income.* ASU 2011-05 eliminates the option to present components of other comprehensive income as part of the statement of changes in equity and requires that all non owner changes in equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. ASU 2011-05 requires retrospective application and will be effective for interim and annual reporting periods beginning after December 15, 2011. We do not believe the adoption of ASU 2011-05 will have significant impact on our disclosures of comprehensive income.

NOTE 2. REAL ESTATE

Acquisitions

As noted above, as part of the Formation Transactions, we acquired the controlling interests in the Waikiki Beach Walk entities and the Solana Beach Centre entities for Operating Partnership units and common shares with a value of approximately $33.9 million. The contribution or acquisition by merger of interests in these entities was accounted for as an acquisition under the acquisition method of accounting and recognized at the estimated fair value of acquired assets and assumed liabilities on the date of such contribution or acquisition. Prior to acquisition, our Predecessor had an 80% noncontrolling interest in the Waikiki Beach Walk entities and a 50% noncontrolling interest in the Solana Beach Centre entities. Upon acquisition, we remeasured the assets and liabilities at fair value and recorded gains of $4.8 million and $41.6 million on the Waikiki Beach Walk entities and the Solana Beach

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Centre entities, respectively, which are classified as gain on acquisition in the accompanying statement of operations. These gains were calculated based on the difference between the fair value of our Predecessor s ownership interests of $31.3 million and $26.0 million compared to the Predecessor s historical cost interests of $26.5 million and $(15.6) million in the Waikiki Beach Walk entities and Solana Beach Centre entities, respectively.

The fair values assigned to identifiable intangible assets acquired were based on estimates and assumptions determined by management. Using information available at the time the acquisition closed, we allocated the total consideration to tangible assets and liabilities and identified intangible assets and liabilities.

The allocation of the consideration paid for the acquired assets and liabilities was as follows (in thousands):

	Solana Beach Towne Centre	Solana Beach Corporate Centre	Waikiki Beach Walk Retail and Hotel	Total
Land	$ 40,980	$ 14,896	$ 76,635	$ 132,511
Building	35,605	42,094	122,985	200,684
Land improvements	1,750	974	2,276	5,000
Tenant improvements	1,487	1,919	1,801	5,207
Furniture and fixtures			7,910	7,910
Total real estate	79,822	59,883	211,607	351,312
Cash and cash equivalents	957	718	13,547	15,222
Restricted cash	282	200	1,297	1,779
Accounts receivable, net	67		2,168	2,235
Lease intangibles	6,995	5,536	15,997	28,528
Prepaid expenses and other assets	22	45	266	333
Total assets	$ 88,145	$ 66,382	$ 244,882	$ 399,409
Secured notes payable	$ 39,738	$ 49,252	$ 198,618	$ 287,608
Fair market favorable debt value		(600)	(19,000)	(19,600)
Notes payable to affiliates			14,824	14,824
Accounts payable and accrued expenses	924	542	6,520	7,986
Security deposits payable	238	320	861	1,419
Lease intangibles	11,390	125	3,530	15,045
Other liabilities and deferred credits	192	331	442	965
Total liabilities	$ 52,482	$ 49,970	$ 205,795	$ 308,247

We have included the results of operations for each of these acquired entities in our consolidated statements of operations from January 19, 2011, the date of acquisition. For the period January 19, 2011 through September 30, 2011, the acquired entities contributed $42.6 million to total revenue, $35.3 million to operating expenses, $7.3 million to operating income and $(5.3) million to net income (loss).

On March 11, 2011, we acquired an approximately 364,000 square foot, 16-story, LEED Platinum certified office building located at 100 SW Main Street, in Portland, Oregon (First & Main). The purchase price for First & Main was approximately $128.9 million, excluding closing costs of approximately $0.1 million, which are included in other income (expense), net on the statement of operations. The purchase was funded using cash on hand and structured to accommodate a reverse tax deferred exchange in conjunction with the sale of Valencia Corporate Center pursuant to the provisions of Section 1031 of the Code and applicable state revenue and taxation code sections.

On July 1, 2011, we acquired the Lloyd District Portfolio, consisting of approximately 600,000 rentable square feet on more than 16 acres located in the Lloyd District of Portland, Oregon. The Lloyd District Portfolio is comprised of six office buildings within four contiguous blocks, including (i) a condominium interest in the 20-story Lloyd Tower, (ii) the 16-story Lloyd 700 Building and (iii) four low-rise landmark buildings within Oregon Square. The purchase price was approximately $91.6 million, excluding closing costs of approximately $0.1 million, which are included in other income (expense), net on the statement of operations. The purchase was funded using cash on hand. The acquisition was structured to accommodate a possible tax deferred exchange pursuant to the provisions of Section 1031 of the Code and applicable state revenue and taxation code sections.

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On September 20, 2011, we acquired the Solana Beach Highway 101 property, consisting of approximately 1.7 acres located in Solana Beach, California. The property consists primarily of land held for future development. The purchase price was approximately $6.8 million, excluding closing costs of approximately $0.2 million, which are included in other income (expense), net on the statement of operations. The purchase was funded through cash on hand.

The fair values assigned to identifiable intangible assets acquired were based on estimates and assumptions determined by management. Using information available at the time the acquisition closed, we allocated the total consideration to tangible assets and liabilities and identified intangible assets and liabilities. We may adjust the preliminary purchase price allocation after obtaining more information about asset valuations and liabilities assumed. The allocation of the purchase price for First & Main, Lloyd District Portfolio and Solana Beach Highway 101 was as follows (in thousands):

	First & Main	Lloyd District Portfolio	Solana Beach Highway 101	Total
Land	$ 14,697	$ 18,660	$ 6,692	$ 40,049
Building	102,597	53,325	107	156,029
Land improvements	151	1,444		1,595
Tenant improvements	6,991	5,909	11	12,911
Construction in progress		723		723
Total real estate	124,436	80,061	6,810	211,307
Accounts receivable, net	153			153
Lease intangibles	9,578	13,164	40	22,782
Prepaid expenses and other assets	296	10		306
Total assets	$ 134,463	$ 93,235	$ 6,850	$ 234,548
Accounts payable and accrued expenses	$ 387	$ 188	$ 12	$ 587
Security deposits payable		426	6	432
Other liabilities and deferred credits		519		519
Lease intangibles	5,199	502		5,701
Total liabilities	$ 5,586	$ 1,635	$ 18	$ 7,239

We have included the results of operations for First & Main, Lloyd District Portfolio and Solana Beach Highway 101 in our consolidated statements of operations from the date of acquisition. For the period of acquisition through September 30, 2011, First & Main, Lloyd District Portfolio and Solana Beach Highway 101 contributed $9.6 million to total revenue, $7.9 million to operating expenses, $1.7 million to operating income and $0.5 million to net income.

Pro Forma Financial Information

The unaudited financial information in the table below summarizes the combined results of operations of the Waikiki Beach Walk entities, Solana Beach Centre entities, First & Main, Lloyd District Portfolio and Solana Beach Highway 101 with the historical results of operations of the Company/Predecessor on a pro forma basis, as though the entities had been acquired on January 1, 2010. The pro forma financial information for the nine months ended September 30, 2010, also includes the pro forma results of operations for The Landmark at One Market, which was acquired by the Predecessor on June 30, 2010, as though the entity had been acquired on January 1, 2010. The pro forma financial information is presented for informational purposes only and is not indicative of the results of operations that would have been achieved if the acquisitions had taken place on January 1, 2010. The pro forma financial information includes adjustments to depreciation expense for acquired property and equipment, adjustments to amortization charges for acquired intangible assets and liabilities, adjustments to straight-line rent revenue and the removal of the gain on acquisition of the controlling interests of the Solana Beach Centre entities and Waikiki Beach Walk entities for the nine months ended September 30, 2011 and The Landmark at One Market for the nine months ended September 30, 2010.

The following table summarizes the unaudited pro forma financial information (in thousands):

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	Nine months ended September 30, 2011	2010
Total revenue	$ 166,575	$ 158,003
Total operating expenses	120,689	109,312
Operating income	45,886	48,691
Net loss	$ (26,159) (1)	$ (993)

(1) The net loss for the nine months ended September 30, 2011 includes one-time expenses for the early extinguishment of debt and loan transfer and consent fees but excludes the gain on acquisition of the controlling interests in the Solana Beach Centre entities and the Waikiki Beach Walk entities.

Dispositions

On August 30, 2011, we sold Valencia Corporate Center for a sales price of $31.0 million. The property is located in Santa Clarita, California. The decision to sell Valencia Corporate Center was a result of our desire to focus resources on our core, high-barrier-to-entry markets. The sale was completed as a reverse tax deferred exchange in conjunction with the acquisition of First & Main pursuant to the provisions of Section 1031 of the Code and applicable state revenue and taxation code sections. As a result of the sale, Valencia Corporate Center no longer serves as a borrowing base property under our revolving credit facility.

We determined that Valencia Corporate Center became a discontinued operation in the third quarter of 2011. We have, therefore, classified Valencia Corporate Center s net assets, liabilities and operating results as discontinued operations on our balance sheets and our statements of operations for all periods prior to the sale.

Net revenue and net income from the property s discontinued operations were as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Net revenue from discontinued operations	$ 767	$ 1,107	$ 3,099	$ 3,314
Results from discontinued operations				
Net income from discontinued operations	327	44	1,119	232
Gain on sale of real estate from discontinued operations	3,981		3,981	
Total net income from discontinued operations	$ 4,308	$ 44	$ 5,100	$ 232

NOTE 3. INVESTMENTS IN REAL ESTATE JOINT VENTURES

As of December 31, 2010, our Predecessor had four joint venture arrangements with unrelated third parties. We owned from 25% to 80% of each of these ventures. For two of these ventures, we were the general partner or managing member; however, the outside owners were either a co-general partner or had substantive participating rights, and we could not make significant decisions without the outside owners approval. Accordingly, we accounted for these investments under the equity method. We acted as the manager of the three properties owned by these two ventures and received fees in accordance with service contracts (Note 15).

For the joint venture that owned a mixed-use property in Honolulu, Hawaii, we had an effective 80% limited ownership interest in the property; however, the outside owner was the managing member and managed the day-to-day business of the property. In addition, we did not have kick-out rights relating to the outside owner s managing membership interest. Accordingly, we accounted for these investments under the equity method of accounting.

The properties owned by these unconsolidated joint ventures at December 31, 2010 were as follows:

Property	Type	Location
Solana Beach Towne Centre	Retail	Solana Beach, CA
Solana Beach Corporate Centre	Office	Solana Beach, CA
Fireman s Fund Headquarters	Office	Novato, CA
Waikiki Beach Walk	Mixed Use	Honolulu, HI

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As noted above, as part of the Formation Transactions, we acquired the unrelated third party s interest in Solana Beach Towne Centre, Solana Beach Corporate Centre and Waikiki Beach Walk. We consolidated the operations of these properties subsequent to the Formation Transactions. The Predecessor s ownership interest in Fireman s Fund Headquarters was not acquired, and rather the ownership interests in this entity were distributed to its owners as part of the Formation Transactions. In addition, we no longer receive fee income from these ventures.

The Waikiki Beach Walk property has a 47.7% investment in WBW CHP LLC, an entity that was formed to construct a chilled water plant to provide air conditioning to the property and other adjacent facilities. The operating expenses of WBW CHP LLC are recovered through reimbursements from its members. Annual contributions are made to fund maintenance reserves. Upon acquisition of the Waikiki Beach Walk property, the investment in WBW CHP LLC was recorded at its fair value of $0.

NOTE 4. ACQUIRED IN-PLACE LEASES AND ABOVE/BELOW MARKET LEASES

The following summarizes our acquired lease intangibles, which are included in prepaid expenses and other assets and other liabilities and deferred credits, as of September 30, 2011 and December 31, 2010 (in thousands):

	September 30, 2011	December 31, 2010
In-place leases	$ 60,540	$ 41,108
Accumulated amortization	(29,038)	(30,901)
Above market leases	43,064	33,557
Accumulated amortization	(24,344)	(21,433)
Acquired lease intangible assets, net	50,222	22,331
Below market leases	70,332	54,576
Accumulated accretion	(20,618)	(21,546)
Acquired lease intangible liabilities, net	$ 49,714	$ 33,030

NOTE 5. MARKETABLE SECURITIES

Our portfolio of marketable securities is comprised of debt securities that are classified as trading securities. At September 30, 2011, our marketable securities consisted of investments in mortgage-backed securities issued by the Government National Mortgage Association (GNMA securities). We report our trading securities at fair value, based on quoted market prices (Level 1 of the fair value hierarchy see Note 6). Gains and losses resulting from the mark-to-market of these securities are recognized as unrealized gains or losses in income. For the nine months ended September 30, 2011, unrealized losses in our statement of operations, which are included in other income (expense), were insignificant.

NOTE 6. FAIR VALUE OF FINANCIAL INSTRUMENTS

A fair value measurement is based on the assumptions that market participants would use in pricing an asset or liability. The hierarchy for inputs used in measuring fair value is as follows:

1. Level 1 Inputs quoted prices in active markets for identical assets or liabilities

2. Level 2 Inputs observable inputs other than quoted prices in active markets for identical assets and liabilities

3. Level 3 Inputs unobservable inputs

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, for disclosure purposes, the level within which the fair value measurement is categorized is based on the lowest level input that is significant to the fair value measurement.

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Except as disclosed below, the carrying amount of our financial instruments approximates their fair value. The fair value of our secured notes payable and unsecured notes payable is sensitive to fluctuations in interest rates. Discounted cash flow analysis (Level 2) is generally used to estimate the fair value of our mortgages and notes payable, using rates ranging from 3.7% to 8.7%. Considerable judgment is necessary to estimate the fair value of financial instruments. The estimates of fair value presented herein are not necessarily indicative of the amounts that could be realized upon disposition of the financial instruments. A summary of the carrying amount and fair value of our notes payable is as follows (in thousands):

	September 30, 2011		December 31, 2010	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Secured notes payable, including discontinued operations	$ 943,900	$ 974,198	$ 851,547	$ 871,016
Unsecured notes payable			$ 38,013	$ 38,023

Due to their related party nature, notes with affiliates outstanding at December 31, 2010 cannot be measured at fair value.

NOTE 7. PREPAID EXPENSES AND OTHER ASSETS

Prepaid expenses and other assets consist of the following:

	September 30, 2011	December 31, 2010
	(In thousands)	
Leasing commissions, net of accumulated amortization of $13,955 and $13,136, respectively	$ 17,782	$ 10,724
Acquired above market leases, net	18,720	12,124
Acquired in-place leases, net	31,502	10,207
Lease incentives, net of accumulated amortization of $1,757 and $1,480, respectively	1,943	2,220
Other intangible assets, net of accumulated amortization of $3,174 and $1,325, respectively	1,732	364
Debt issuance costs, net of accumulated amortization of $2,203 and $2,683, respectively	3,698	2,209
Prepaid expenses, deposits, and other	1,744	5,870
Total prepaid expenses and other assets	$ 77,121	$ 43,718

Lease incentives are amortized over the term of the related lease and included as a reduction of rental income in the statement of operations. Prepaid expenses and deposits included $5.3 million in costs related to the Offering at December 31, 2010, which were recorded as a reduction of capital at the time of the Offering.

NOTE 8. OTHER LIABILITIES AND DEFERRED CREDITS

Other liabilities and deferred credits consist of the following:

	September 30, 2011	December 31, 2010
	(In thousands)	
Acquired below market leases, net	$ 49,714	$ 33,030
Prepaid rent and deferred revenue	5,936	5,145
Straight-line rent liability	601	622
Deferred rent expense and lease intangible	1,139	
Deferred compensation	485	
Other liabilities	80	49
Total other liabilities and deferred credits	$ 57,955	$ 38,846

Straight-line rent liability relates to leases which have rental payments that decrease over time or one-time upfront payments for which the rental revenue is deferred and recognized on a straight-line basis.

NOTE 9. DEBT

The following is a summary of our total debt outstanding as of September 30, 2011 and December 31, 2010 (in thousands):

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American Assets Trust, Inc.

Notes to Consolidated Financial Statements (Continued)

September 30, 2011

(Unaudited)

Description of Debt	Principal Balance as of September 30, 2011	Principal Balance as of December 31, 2010	Stated Interest Rate as of September 30, 2011	Stated Maturity Date
Secured Notes Payable				
160 King Street (1)(2)(5)(10)	$	$ 8,564	N/A	November 1, 2012
Carmel Country Plaza (1)(4)		10,145	N/A	January 2, 2013
Santa Fe Park RV Resort (1)(4)		1,856	N/A	January 2, 2013
Lomas Santa Fe Plaza (1)(4)		19,599	N/A	May 1, 2013
Torrey Reserve South Court (1)(4)		12,892	N/A	May 1, 2013
Carmel Mountain Plaza (1)(4)		62,907	N/A	June 1, 2013
Alamo Quarry Market (4)(6)	96,538	98,011	5.670%	January 8, 2014
160 King Street (7)	31,800	32,931	5.680%	May 1, 2014
Waikele Center (5)	140,700	140,700	5.145%	November 1, 2014
The Shops at Kalakaua (5)	19,000	19,000	5.449%	May 1, 2015
The Landmark at One Market (5)(6)	133,000	133,000	5.605%	July 5, 2015
Del Monte Center (5)	82,300	82,300	4.926%	July 8, 2015
Rancho Carmel Plaza (1)(4)		8,049	N/A	January 1, 2016
First & Main (5)	84,500		3.965%	July 1, 2016
Imperial Beach Gardens (5)	20,000	20,000	6.163%	September 1, 2016
Mariner s Point (5)	7,700	7,700	6.092%	September 1, 2016
Torrey Reserve ICW Plaza (1)(5)		43,000	N/A	February 1, 2017
South Bay Marketplace (5)	23,000	23,000	5.477%	February 10, 2017
Waikiki Beach Walk Retail (5)	130,310		5.390%	July 1, 2017
Solana Beach Corporate Centre III-IV (11)	37,330		6.390%	August 1, 2017
Loma Palisades (5)	73,744	73,744	6.090%	July 1, 2018
Torrey Reserve North Court (4)	21,984	22,165	7.220%	June 1, 2019
Torrey Reserve Torrey Daycare (1)(8)		1,660	N/A	June 1, 2019
Torrey Reserve VCI, VCII, VCIII (4)				