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

OR

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

Commission File Number 1-9317

COMMONWEALTH REIT

(Exact Name of Registrant as Specified in Its Charter)

Maryland	**04-6558834**
(State or Other Jurisdiction of Incorporation or Organization)	(IRS Employer Identification No.)

Two Newton Place, 255 Washington Street, Suite 300, Newton, Massachusetts 02458-1634

(Address of Principal Executive Offices) (Zip Code)

617-332-3990

(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 x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

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 the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check One):

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

Number of registrant s common shares of beneficial interest, $0.01 par value per share, outstanding as of November 2, 2011: **83,721,736**.

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FORM 10-Q

September 30, 2011

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References in this Form 10-Q to we , us and our refers to CommonWealth REIT and its consolidated subsidiaries, unless otherwise noted.

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PART I Financial Information

Item 1. Financial Statements

COMMONWEALTH REIT

CONDENSED CONSOLIDATED BALANCE SHEETS

(amounts in thousands, except share data)

(unaudited)

	September 30, 2011	December 31, 2010
ASSETS		
Real estate properties:		
Land	$ 1,445,301	$ 1,339,133
Buildings and improvements	5,746,893	5,018,125
	7,192,194	6,357,258
Accumulated depreciation	(932,293)	(850,261)
	6,259,901	5,506,997
Properties held for sale	43,573	114,426
Acquired real estate leases, net	360,293	233,913
Equity investments	178,652	171,464
Cash and cash equivalents	210,673	194,040
Restricted cash	10,102	5,082
Rents receivable, net of allowance for doubtful accounts of $12,421 and $12,550, respectively	212,737	191,237
Other assets, net	182,259	171,380
Total assets	$ 7,458,190	$ 6,588,539
LIABILITIES AND SHAREHOLDERS EQUITY		
Revolving credit facility	$ 235,000	$
Senior unsecured debt, net	2,687,600	2,854,540
Mortgage notes payable, net	633,935	351,526
Liabilities related to properties held for sale	463	1,492
Accounts payable and accrued expenses	148,525	123,842
Assumed real estate lease obligations, net	72,619	65,940
Rent collected in advance	35,593	27,988
Security deposits	23,710	22,523
Due to related persons	28,448	8,998
Total liabilities	3,865,893	3,456,849
Shareholders equity:		
Preferred shares of beneficial interest, $0.01 par value:		
50,000,000 shares authorized;		

Series C preferred shares; 7 1/8% cumulative redeemable since February 15, 2011; 6,000,000 shares issued and outstanding, aggregate liquidation preference $150,000	145,015	145,015
Series D preferred shares; 6 1/2% cumulative convertible; 15,180,000 shares issued and outstanding, aggregate liquidation preference $379,500	368,270	368,270
Series E preferred shares; 7 1/4% cumulative redeemable on or after May 15, 2016; 11,000,000 and zero shares issued and outstanding, respectively, aggregate liquidation preference $275,000	265,391	
Common shares of beneficial interest, $0.01 par value:		
350,000,000 shares authorized; 83,721,736 and 72,138,686 shares issued and outstanding, respectively	837	721
Additional paid in capital	3,613,828	3,348,849
Cumulative net income	2,467,448	2,372,337
Cumulative other comprehensive (loss) income	(21,489)	4,706
Cumulative common distributions	(2,784,169)	(2,675,956)
Cumulative preferred distributions	(462,834)	(432,252)
Total shareholders equity	3,592,297	3,131,690
Total liabilities and shareholders equity	$ 7,458,190	$ 6,588,539

See accompanying notes

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COMMONWEALTH REIT

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(amounts in thousands, except per share data)

(unaudited)

	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Rental income	$ 238,790	$ 193,059	$ 662,596	$ 572,205
Expenses:				
Operating expenses	100,912	83,023	275,760	240,280
Depreciation and amortization	56,389	42,794	159,072	130,560
General and administrative	11,450	9,704	33,559	28,081
Loss on asset impairment				21,491
Acquisition related costs	4,805	1,559	9,722	2,965
Total expenses	173,556	137,080	478,113	423,377
Operating income	65,234	55,979	184,483	148,828
Interest and other income	369	571	1,428	2,134
Interest expense (including net amortization of debt discounts, premiums and deferred financing fees of $1,515, $1,784, $5,467 and $5,260, respectively)	(49,423)	(44,192)	(145,037)	(133,716)
Gain (loss) on early extinguishment of debt	310	(796)	310	(796)
Equity in earnings of investees	2,768	1,999	8,390	6,643
Gain on issuance of shares by an equity investee	11,177	18,390	11,177	34,808
Income from continuing operations before income tax expense	30,435	31,951	60,751	57,901
Income tax (expense) benefit	(307)	34	(743)	(329)
Income from continuing operations	30,128	31,985	60,008	57,572
Discontinued operations:				
Income from discontinued operations	653	6,673	2,777	16,877
Loss on asset impairment from discontinued operations	(9,247)		(9,247)	
Loss on early extinguishment of debt from discontinued operations		(248)		(248)
Gain on sale of properties from discontinued operations	7,001	4,568	41,573	4,568
Income before gain on sale of properties	28,535	42,978	95,111	78,769
Gain on sale of properties		22,832		34,336
Net income	28,535	65,810	95,111	113,105
Preferred distributions	(13,823)	(12,667)	(33,162)	(38,001)
Net income available for common shareholders	$ 14,712	$ 53,143	$ 61,949	$ 75,104
Weighted average common shares outstanding basic	81,536	65,173	75,307	62,198
Weighted average common shares outstanding diluted	88,834	72,471	82,605	69,496
Basic and diluted earnings per common share:				
	$ 0.20	$ 0.65	$ 0.36	$ 0.87

Income from continuing operations available for common shareholders								
(Loss) income from discontinued operations	$	(0.02)	$	0.17	$	0.47	$	0.34
Net income available for common shareholders	$	0.18	$	0.82	$	0.82	$	1.21

See accompanying notes

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COMMONWEALTH REIT

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(amounts in thousands)

(unaudited)

	Nine Months Ended September 30, 2011	2010
Cash flows from operating activities:		
Net income	$ 95,111	$ 113,105
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation	123,324	117,575
Net amortization of debt discounts, premiums and deferred financing fees	5,467	5,644
Amortization of acquired real estate leases	33,654	23,420
Other amortization	12,186	12,216
Loss on asset impairment	9,247	21,491
(Gain) loss on early extinguishment of debt	(310)	1,044
Equity in earnings of investees	(8,390)	(6,643)
Gain on issuance of shares by an equity investee	(11,177)	(34,808)
Distributions of earnings from investees	8,279	6,660
Gain on sale of properties	(41,573)	(38,904)
Change in assets and liabilities:		
(Increase) decrease in restricted cash	(5,020)	5,808
Increase in rents receivable and other assets	(56,972)	(36,581)
Increase (decrease) in accounts payable and accrued expenses	15,356	(10,951)
Increase in rent collected in advance	6,667	2,049
Increase (decrease) in security deposits	2,072	(59)
Increase in due to related persons	18,271	17,293
Cash provided by operating activities	206,192	198,359
Cash flows from investing activities:		
Real estate acquisitions and improvements	(829,520)	(406,983)
Investment in direct financing lease, net	(38,635)	
Principal payments received from direct financing lease	3,643	
Principal payments received from real estate mortgage receivable	8,183	
Proceeds from investment in marketable pass through certificates		8,000
Proceeds from sale of properties, net	263,170	230,911
Distributions in excess of earnings from investees	4,159	5,379
Investment in Affiliates Insurance Company		(75)
Increase in restricted cash		(1,221)
Cash used in investing activities	(589,000)	(163,989)
Cash flows from financing activities:		
Proceeds from issuance of common shares, net	264,056	430,778
Proceeds from issuance of preferred shares, net	265,391	
Proceeds from borrowings	750,000	1,148,632
Payments on borrowings	(738,904)	(1,317,027)
Deferred financing fees	(853)	(9,565)
Distributions to common shareholders	(108,213)	(90,168)

Distributions to preferred shareholders		(30,582)		(38,001)
Purchase of noncontrolling equity interest				(2,500)
Cash provided by financing activities		400,895		122,149
Effect of exchange rate changes on cash		(1,454)		
Increase in cash and cash equivalents		16,633		156,519
Cash and cash equivalents at beginning of period		194,040		18,204
Cash and cash equivalents at end of period	$	210,673	$	174,723

See accompanying notes

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COMMONWEALTH REIT

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)

(amounts in thousands)

(unaudited)

	Nine Months Ended September 30, 2011	2010
Supplemental cash flow information:		
Interest paid	$ 151,259	$ 142,311
Taxes paid	403	543
Non-cash investing activities:		
Real estate acquisitions	$ (321,235)	$
Investment in real estate mortgage receivable		(8,288)
Non-cash financing activities:		
Issuance of common shares	$ 1,039	$ 896
Assumption of mortgage notes payable	321,235	

See accompanying notes

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COMMONWEALTH REIT

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

Note 1. Basis of Presentation

The accompanying condensed consolidated financial statements of CommonWealth REIT, or CWH, we, us or our, and its subsidiaries have been prepared without audit. Certain information and footnote disclosures required by U.S. generally accepted accounting principles, or GAAP, for complete financial statements have been condensed or omitted. We believe the disclosures made are adequate to make the information presented not misleading. However, the accompanying condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes contained in our Annual Report on Form 10-K for the year ended December 31, 2010, or our Annual Report. In the opinion of our management, all adjustments, which include only normal recurring adjustments considered necessary for a fair presentation, have been included. All intercompany transactions and balances with or among our subsidiaries have been eliminated. Operating results for interim periods are not necessarily indicative of the results that may be expected for the full year. Reclassifications have been made to the prior years financial statements to conform to the current year s presentation.

The preparation of financial statements in conformity with GAAP requires us to make estimates and assumptions that affect reported amounts. Actual results could differ from those estimates. Significant estimates in the condensed consolidated financial statements include the allowance for doubtful accounts, purchase price allocations, useful lives of fixed assets and impairment of real estate and intangible assets.

Note 2. Recent Accounting Pronouncements

In June 2011, the Financial Accounting Standards Board issued Accounting Standards Update No. 2011-05, *Presentation of Comprehensive Income*. This standard eliminates the current option to report other comprehensive income and its components in the statement of shareholders equity. This standard is intended to enhance comparability between entities that report under GAAP and to provide a more consistent method of presenting non-owner transactions that affect an entity s equity. This standard is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. We do not expect the adoption of this standard to cause any material changes to our condensed consolidated financial statements.

Note 3. Real Estate Properties

Since January 1, 2011, we acquired 23 properties with 6,806,615 square feet for an aggregate purchase price of $1,144,852, including the assumption of $321,235 of mortgage debt and excluding closing costs, and we sold 20 properties with approximately 2,148,000 square feet for an aggregate sale price of $265,145, excluding closing costs. We also funded $65,176 of improvements to our owned properties during the nine months ended September 30, 2011. In addition, we have entered into agreements to acquire two properties with a combined 1,891,243 square feet for an aggregate purchase price of $249,600, including the assumption of approximately $148,000 of mortgage debt and excluding closing costs. We have also entered an agreement to sell 16 properties with approximately 570,000 combined square feet for $6,500, excluding closing costs. Details of our completed and pending acquisitions and sales during 2011 are as follows:

Property Acquisitions:

In January 2011, we acquired three office properties located in Boca Raton, FL with a combined 639,830 square feet. The aggregate purchase price was $171,000, excluding closing costs. We allocated $15,900 to land, $129,790 to buildings and improvements and $25,310 to acquired real estate leases.

Also in January 2011, we acquired an office property located in Columbia, SC with 115,028 square feet. The purchase price was $12,025, excluding closing costs. We allocated $1,180 to land, $8,886 to buildings and improvements, $2,072 to acquired real estate leases and $113 to assumed real estate lease obligations.

Also in January 2011, we acquired an office property located in Chelmsford, MA with 98,048 square feet. The purchase price was $10,000, excluding closing costs. We allocated $1,410 to land, $7,322 to buildings and improvements, $1,711 to acquired real estate leases and $443 to assumed real estate lease obligations.

In February 2011, we acquired an office property located in Montvale, NJ with 119,089 square feet. The purchase price was $20,600, excluding closing costs. We allocated $3,650 to land, $13,726 to buildings and improvements, $3,954 to acquired real estate leases and $730 to assumed real estate lease obligations.

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COMMONWEALTH REIT

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(dollars in thousands, except per share data)

In March 2011, we acquired four properties located in Phoenix, AZ with a combined 1,063,364 square feet. The aggregate purchase price was $136,500, excluding closing costs. We allocated $30,985 to land, $55,733 to buildings and improvements, $38,635 to investment in direct financing lease, $15,706 to acquired real estate leases, $500 to assumed real estate lease obligations and $4,059 to notes payable.

In May 2011, we acquired an office property located in Chicago, IL with 1,070,388 square feet. The purchase price was $162,202, excluding closing costs. We allocated $34,300 to land, $110,245 to buildings and improvements, $24,399 to acquired real estate leases and $6,742 to assumed real estate lease obligations.

In June 2011, we acquired four office properties located in Stafford, VA with a combined 149,023 square feet. The aggregate purchase price was $25,725, including the assumption of $14,960 of mortgage debt and excluding closing costs. We allocated $4,150 to land, $21,795 to buildings and improvements, $815 to acquired real estate leases, $101 to assumed real estate lease obligations and $934 to premium on mortgage debt.

Also in June 2011, we acquired four office properties located in Folsom, CA with a combined 269,254 square feet. The aggregate purchase price was $46,300, including the assumption of $41,275 of mortgage debt and excluding closing costs. We allocated $4,370 to land, $41,748 to buildings and improvements, $3,729 to acquired real estate leases, $262 to assumed real estate lease obligations and $3,285 to premium on mortgage debt.

In July 2011, we acquired an office property located in Birmingham, AL with 514,893 square feet. The purchase price was $68,500, excluding closing costs. We allocated $1,740 to land, $49,565 to buildings and improvements, $17,552 to acquired real estate leases and $357 to assumed real estate lease obligations.

In August 2011, we acquired two office properties located in Chicago, IL with a combined 1,510,707 square feet. The aggregate purchase price was $390,000, including the assumption of $265,000 of mortgage debt and excluding closing costs. We allocated $34,980 to land, $310,574 to buildings and improvements, $62,016 to acquired real estate leases, $3,899 to assumed real estate lease obligations and $13,671 to premium on mortgage debt.

Also in August 2011, we acquired an office property located in New Orleans, LA with 1,256,991 square feet. The purchase price was $102,000, excluding closing costs. We allocated $9,100 to land, $78,540 to buildings and improvements, $17,743 to acquired real estate leases and $3,383 to assumed real estate lease obligations.

Also in August 2011, we entered an agreement to acquire an office property located in Chicago, IL with 1,006,574 square feet. The purchase price is $150,600, including the assumption of approximately $148,000 of mortgage debt and excluding closing costs. We expect to acquire this property during the fourth quarter of 2011; however, this acquisition is subject to our satisfactory completion of customary closing conditions, including the assumption of existing mortgage debt. Accordingly, we can provide no assurance that we will acquire this property in that time period or at all.

In October 2011, we entered an agreement to acquire an office property located in Hartford, CT with 884,669 square feet. The purchase price is $99,000, excluding closing costs. We expect to acquire this property during the fourth quarter of 2011; however, this acquisition is subject to our satisfactory completion of diligence and other customary closing conditions and we can provide no assurance that we will acquire this property in that time period or at all.

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COMMONWEALTH REIT

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(dollars in thousands, except per share data)

Property Sales:

In November 2010, we entered into various agreements to sell 27 properties which are majority leased as medical office, clinic and biotech laboratory buildings to Senior Housing Properties Trust, or SNH, for an aggregate sale price of $470,000, excluding closing costs. In 2010, we sold 21 of these properties containing approximately 2,066,000 square feet for an aggregate sale price of $374,130, excluding closing costs, and recognized net gains totaling $133,272. In January 2011, we sold the remaining six properties containing approximately 737,000 square feet for an aggregate sale price of $95,870, excluding closing costs, and recognized gains totaling $34,666. In September 2011, we sold to SNH 13 additional properties located in eight states with approximately 1,310,000 square feet for an aggregate sale price of $167,000, excluding closing costs, and recognized net gains totaling $7,001. We previously granted SNH a right of first refusal to purchase certain of our properties if we sought to sell them. In connection with our September 2011 sale of 13 properties to SNH, we and SNH terminated the existing SNH right of first refusal as substantially all of the properties that were subject to that right of first refusal had been purchased by SNH.

In February 2011, we sold an industrial property located in Adairsville, GA with 101,400 square feet for $2,275, excluding closing costs, and recognized a loss of $94.

As of September 30, 2011, we had seven office properties with a combined 1,054,000 square feet and 20 industrial & other properties with a combined 1,835,000 square feet classified as held for sale in our condensed consolidated balance sheet. In October 2011, we entered an agreement to sell 16 of the 20 industrial & other properties classified as held for sale, which are located in Dearborn, MI with approximately 570,000 combined square feet for $6,500, excluding closing costs, which approximates the carrying value of these properties as of September 30, 2011. We expect to sell these properties during the fourth quarter of 2011; however, this sale is subject to satisfactory completion of buyer s diligence and other customary closing conditions and we can provide no assurance that we will sell these properties in that time period or at all. We are actively marketing the remaining properties for sale and expect to sell them within the next year; however, we can provide no assurance that we will receive acceptable offers to purchase these properties or that we will sell them.

We classify all properties actively marketed, under contract, in active negotiations or otherwise probable for sale within one year as held for sale in our condensed consolidated balance sheets. Results of operations for properties sold or held for sale are included in discontinued operations in our condensed consolidated statements of income, except for properties sold during 2010 to Government Properties Income Trust, or GOV. Properties that we sold to GOV are not considered discontinued operations under GAAP because of our retained equity interest in this former subsidiary. Summarized balance sheet and income statement information for properties sold or held for sale, other than properties sold to GOV, is as follows:

Balance Sheets:

	September 30, 2011	December 31, 2010
Real estate properties	$ 40,487	$ 105,291
Acquired real estate leases	114	1,104
Rents receivable	202	4,446
Other assets, net	2,770	3,585
Properties held for sale	$ 43,573	$ 114,426
Assumed real estate lease obligations	$ 7	$ 7
Rent collected in advance	249	1,187
Security deposits	207	298
Liabilities related to properties held for sale	$ 463	$ 1,492

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COMMONWEALTH REIT

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(dollars in thousands, except per share data)

Income Statements:

	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Rental income	$ 8,296	$ 24,999	$ 24,994	$ 73,590
Operating expenses	(5,832)	(11,012)	(16,219)	(32,554)
Depreciation and amortization	(1,336)	(5,768)	(4,467)	(17,440)
General and administrative	(470)	(996)	(1,433)	(2,925)
Acquisition related costs	(5)		(148)	(7)
Operating income	653	7,223	2,727	20,664
Interest and other income		1	50	3
Interest expense		(551)		(3,790)
Income from discontinued operations	$ 653	$ 6,673	$ 2,777	$ 16,877

Note 4. Investment in Direct Financing Lease

Our investment in a direct financing lease relates to the triple net lease with a term that exceeds 75% of the useful life of one office tower located within a mixed use property in Phoenix, AZ that we acquired in March 2011. We recognize direct financing lease income using the effective interest method to produce a level yield on funds not yet recovered. Estimated unguaranteed residual value represents our estimate of the fair value of the leased asset at the expiration of the lease, which does not exceed its original cost. Significant assumptions used in estimating residual value include estimated net cash flows over the remaining lease term and expected future real estate value. The following table summarizes the carrying amount of our net investment in the direct financing lease as of September 30, 2011. The carrying amount of our net investment is included in other assets in our condensed consolidated balance sheet.

	September 30, 2011
Total minimum lease payments receivable	$ 41,207
Estimated unguaranteed residual value of leased asset	4,951
Unearned income	(11,166)
Net investment in direct financing lease	$ 34,992

Additionally, we have determined that no allowance for losses related to our direct financing lease was necessary at September 30, 2011.

Our direct financing lease has an expiration date in 2045. Future minimum rentals receivable on this direct financing lease as of September 30, 2011 are $2,024 in 2011, $8,098 in 2012, $8,098 in 2013, $8,098 in 2014, $8,098 in 2015 and $6,791 thereafter.

Note 5. Equity Investments

At September 30, 2011 and December 31, 2010, we had the following equity investments in GOV and Affiliates Insurance Company, or AIC:

	Ownership Percentage		Equity Investments		Equity in Earnings (Loss)			
					Three Months Ended September 30,		Nine Months Ended September 30,	
	September 30, 2011	December 31, 2010	September 30, 2011	December 31, 2010	2011	2010	2011	2010
GOV	21.1%	24.6%	$ 173,407	$ 166,388	$ 2,740	$ 1,964	$ 8,279	$ 6,660
AIC	14.3%	14.3%	5,245	5,076	28	35	111	(17)
			$ 178,652	$ 171,464	$ 2,768	$ 1,999	$ 8,390	$ 6,643

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COMMONWEALTH REIT

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(dollars in thousands, except per share data)

At September 30, 2011, we owned 9,950,000, or approximately 21.1%, of the common shares of beneficial interest of GOV, with a carrying value of $173,407 and a market value, based on quoted market prices, of $214,025 ($21.51 per share). GOV is a real estate investment trust, or REIT, which primarily owns properties that are majority leased to government tenants and was our wholly owned subsidiary until its initial public offering, or the GOV IPO, in June 2009 when it became a separate public entity. In July 2011, GOV issued 6,500,000 common shares in a public offering for $25.40 per common share, raising net proceeds of approximately $157,900. As a result of this transaction at a price per share above our per share carrying value, our ownership percentage in GOV was reduced from 24.6% prior to this transaction to 21.1% after this transaction, and we recognized a gain of $11,177 (See Note 13).

Since the GOV IPO, we have accounted for our investment in it using the equity method. Under the equity method, we record our percentage share of net earnings of GOV in our consolidated statements of income. Prior to the GOV IPO, the operating results and investments of GOV were included in our results of operations and financial position. The market value of our GOV common shares on the date of the GOV IPO exceeded our carrying value by $13,824. We are amortizing the difference between our carrying value of GOV and our share of the underlying equity of GOV over a 30 year period, which approximates the remaining useful lives of the properties that we initially contributed to GOV. If we determine there is an other than temporary decline in the fair value of this investment, we would record a charge to earnings.

During the nine months ended September 30, 2011 and 2010, we received cash distributions from GOV totaling $12,438 and $12,039, respectively.

The following summarized financial data of GOV is as reported in GOV s Quarterly Report on Form 10-Q for the periods ended September 30, 2011. References in our financial statements to the Quarterly Report on Form 10-Q for GOV are included as textual references only, and the information in GOV s Quarterly Report on Form 10-Q is not incorporated by reference into our financial statements.

		September 30, 2011		**December 31, 2010**
Real estate properties, net	$	1,104,560	$	846,447
Acquired real estate leases, net		103,901		60,097
Cash and cash equivalents		5,724		2,437
Rents receivable, net		22,096		19,200
Other assets, net		30,387		23,107
Total assets	$	1,266,668	$	951,288
Revolving credit facility	$	282,500	$	118,000
Mortgage notes payable		45,608		46,428
Assumed real estate lease obligations, net		11,853		13,679
Other liabilities		28,518		15,784
Shareholders equity		898,189		757,397

Total liabilities and shareholders equity	$ 1,266,668	$ 951,288

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COMMONWEALTH REIT

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(dollars in thousands, except per share data)

Income Statements:

	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Rental income	$ 45,719	$ 30,746	$ 126,718	$ 80,040
Operating expenses	(16,951)	(11,275)	(46,937)	(27,537)
Depreciation and amortization	(10,379)	(6,321)	(27,862)	(16,602)
Acquisition related costs	(1,008)	(2,687)	(2,846)	(4,542)
General and administrative	(2,746)	(1,833)	(7,655)	(4,915)
Operating income	14,635	8,630	41,418	26,444
Interest and other income	54	12	89	80
Interest expense	(3,162)	(1,973)	(8,775)	(5,182)
Equity in earnings (losses) of an investee	28	35	111	(17)
Income before income tax expense	11,555	6,704	32,843	21,325
Income tax benefit (expense)	8	(35)	(94)	(71)
Net income	$ 11,563	$ 6,669	$ 32,749	$ 21,254
Weighted average common shares outstanding	45,322	36,369	42,127	32,265
Net income per common share	$ 0.26	$ 0.18	$ 0.78	$ 0.66

As of September 30, 2011, we have invested $5,209 in AIC, an insurance company organized by Reit Management & Research LLC, or RMR, and five companies to which RMR provides management services, including GOV and SNH. We may invest additional amounts in AIC in the future if the expansion of this insurance business requires additional capital, but we are not obligated to do so. At September 30, 2011, we owned approximately 14.3% of AIC with a current carrying value of $5,245. Although we own less than 20% of AIC, we use the equity method to account for this investment because we believe that we have significant influence over AIC because each of our Trustees is a director of AIC (See Note 13). Under the equity method, we record our percentage share of net earnings from AIC in our consolidated statements of income. If we determine there is an other than temporary decline in the fair value of this investment, we would record a charge to earnings. In evaluating the fair value of this investment, we have considered, among other things, the assets and liabilities held by AIC, AIC s overall financial condition, and the financial condition and prospects for AIC s insurance business.

In 2010, AIC designed a combination property insurance program for us and other AIC shareholders in which AIC participated as a reinsurer. That program was modified and extended in June 2011 for a one year term. Our total premiums paid under this program in 2011 and 2010 were approximately $5,540 and $5,328, respectively. The amounts we expensed in relation to those insurance premiums were $1,385 and $1,332 for the three months ended September 30, 2011 and 2010, respectively, and $4,067 and $1,776 for the nine months ended September 30, 2011 and 2010, respectively. We are currently investigating the possibilities to expand our insurance relationships with AIC to include other types of insurance. By participating in this insurance business with RMR and the other companies to which RMR provides management services, we expect that we may benefit financially by possibly reducing our insurance expenses or by realizing our pro-rata share of any profits of this insurance business.

Note 6. Real Estate Mortgage Receivable

We provided mortgage financing totaling $8,288 at 4.75% per annum maturing in September 2020 in connection with an office property sold in September 2010. This real estate mortgage was prepaid in full in August 2011. As of December 31, 2010, this mortgage had a carrying value of $8,183 and was included in other assets in our condensed consolidated balance sheet.

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COMMONWEALTH REIT

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(dollars in thousands, except per share data)

Note 7. Indebtedness

In March 2011, we repaid at maturity all $168,219 of our floating rate senior notes using borrowings under our revolving credit facility. In June 2011, we repaid at maturity $29,188 of 7.435% mortgage debt using cash on hand. In July 2011, we prepaid at par plus a premium $23,168 of 8.05% mortgage debt due in 2012 using cash on hand and proceeds from our common share offering completed in July 2011. In connection with the mortgage prepaid in July 2011, we recorded a net gain on early extinguishment of debt of $310 from the write off of unamortized premiums and deferred financing fees.

In June 2011, we assumed mortgages on four properties totaling $14,960, which were recorded at a combined fair value of $15,894, in connection with our acquisition of those properties. These debts bear interest at a weighted average rate of 6.35%, require monthly principal and interest payments and mature in 2012 and 2015. In June 2011, we assumed $41,275 of mortgage debt, which was recorded at its fair value of $44,560, in connection with another acquisition. This mortgage debt bears interest at 5.67%, requires monthly interest payments and matures in 2017. In August 2011, we assumed $265,000 of mortgage debt, which was recorded at its fair value of $278,671, in connection with another acquisition. This mortgage debt bears interest at 5.68%, requires monthly interest payments and matures in 2017.

At September 30, 2011, 23 properties costing $913,746 with an aggregate net book value of $804,357 were secured by mortgage notes totaling $633,935 (net of discounts and premiums) maturing from 2012 through 2027.

During October 2011, our $750,000 unsecured revolving credit facility that we use for acquisitions, working capital and general business purposes was amended. Prior to this amendment, our credit facility matured on August 8, 2013 and included a conditional option for us to extend the facility for one year to August 8, 2014. The October 2011 amendment extended the maturity date from August 8, 2013 to October 19, 2015, with an option to extend the facility an additional year to October 19, 2016, subject to satisfaction of certain conditions. The amendment also reduced the interest rate paid on our borrowings under the revolving credit facility from LIBOR plus 200 basis points to LIBOR plus 125 basis points, subject to adjustments based on our credit ratings. In addition, the amended revolving credit facility includes a feature under which our maximum borrowings can be increased up to $1,500,000 in certain circumstances. The interest rate on our revolving credit facility averaged 2.2% and 1.5% per annum for the nine months ended September 30, 2011 and 2010, respectively. As of September 30, 2011, we had $235,000 outstanding and $515,000 available under our revolving credit facility.

In October 2011, our existing term loan which had a principal balance of $400,000 at September 30, 2011 was amended. Prior to this amendment, our term loan had a maturity date of December 15, 2015 and an interest rate set at LIBOR plus 200 basis points, subject to adjustments based on changes to our credit ratings. The October 2011 amendment increased borrowings to $557,000 and, for $500,000 of the term loan, eliminated the prepayment premium, extended the maturity date to December 15, 2016, and reduced interest we pay on borrowings to LIBOR plus 150 basis points, subject to adjustments based on changes to our credit ratings. In addition, the amended term loan includes a feature under which maximum borrowings may be increased by up to $1,000,000 in certain circumstances. Three lenders representing $57,000 of aggregate borrowings were unable to commit to the amended term loan. Accordingly, these three lenders will be subject to the terms of the old term loan and we have agreed to repay these lenders in December 2012 when there will be no prepayment penalty.

Our public debt indentures, our credit facility agreement and our term loan agreement contain a number of financial and other covenants, including a credit facility and term loan covenant that restricts our ability to make distributions under certain circumstances. At September 30, 2011, we believe we were in compliance with all of our covenants under our public debt indentures, our revolving credit facility and term loan agreements.

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(dollars in thousands, except per share data)

Note 8. Shareholders Equity

On May 10, 2011, we issued 2,000 common shares of beneficial interest, par value $0.01 per share, valued at $26.57 per share, the closing price of our common shares on the New York Stock Exchange, or NYSE, on that day, to each of our five Trustees as part of their annual compensation. On September 16, 2011, pursuant to our equity compensation plan, we granted an aggregate of 73,050 common shares valued at $19.96 per share, the closing price of our common shares on the NYSE on that day, to our officers and certain employees of our manager, RMR.

In June 2011, we issued 11,000,000 series E cumulative redeemable preferred shares in a public offering, raising net proceeds of $265,391. Each series E preferred share has a liquidation preference of $25.00 and requires dividends payable in equal quarterly payments of $1.8125, 7 ¼% of the liquidation preference per annum. Our series E preferred shares are redeemable, at our option, for $25.00 each plus accrued and unpaid dividends at any time on or after May 15, 2016. Net proceeds from this offering were used to reduce amounts outstanding under our revolving credit facility.

In July 2011, we issued 11,500,000 common shares in a public offering, raising net proceeds of $264,056. Net proceeds from this offering were used to repay amounts outstanding under our revolving credit facility and for general business purposes, including funding acquisitions.

Other comprehensive income includes unrealized gains or losses on the fair value of our interest rate swap agreements, other investments, and foreign currency translation adjustments. Our interest rate swap agreements qualify as cash flow hedges and convert the floating interest rate on a $175,000 mortgage note payable to a fixed interest rate. The following is a reconciliation of net income to total comprehensive (loss) income for the three and nine months ended September 30, 2011 and 2010:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Comprehensive income:				
Net income	$ 28,535	$ 65,810	$ 95,111	$ 113,105
Unrealized loss on derivative instrument	(6,577)	(5,150)	(8,651)	(15,965)
Unrealized loss on investment in available for sale securities		(141)		(141)
Realized gain on sale of investment in available for sale securities			(18)	
Foreign currency translation adjustments	(33,289)		(17,584)	
Increase in share of investees other comprehensive income	14		58	
Total comprehensive (loss) income	$ (11,317)	$ 60,519	$ 68,916	$ 96,999

Note 9. Income Taxes

We have elected to be taxed as a REIT under the Internal Revenue Code of 1986, as amended, and as such, are generally not subject to federal and most state income taxation on our operating income provided we distribute our taxable income to our shareholders and meet certain organization and operating requirements. We are, however, subject to income tax in Australia and certain states despite our REIT status. During the three and nine months ended September 30, 2011, we recognized current tax expense of $206 and $971, respectively, which includes $88 and $564 of foreign taxes, respectively, and $118 and $407 of certain state taxes, respectively. In addition, during the three and nine months ended September 30, 2011, we recognized a deferred tax provision of $101 and a deferred tax benefit of $228, respectively, related to basis differences in our Australian properties.

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(dollars in thousands, except per share data)

Note 10. Fair Value of Assets and Liabilities

The table below presents certain of our assets and liabilities measured at fair value during 2011, categorized by the level of inputs used in the valuation of each asset and liability:

		Fair Value at Reporting Date Using	
Description	**Total**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Recurring Fair Value Measurements:			
Effective portion of interest rate contracts (1)	$ (15,607)	$ (15,607)	$
Non-recurring Fair Value Measurements:			
Properties held for sale (2)	$ 33,033	$ 24,813	$ 8,220

(1) The fair value of our interest rate swap contracts is determined using the net discounted cash flows of the expected cash flows of each derivative based on the market based interest rate curve (level 2 inputs) and adjusted for our credit spread and the actual and estimated credit spreads of the counterparties (level 3 inputs). Although we have determined that the majority of the inputs used to value our derivatives fall within level 2 of the fair value hierarchy, the credit valuation adjustments associated with our derivatives utilize level 3 inputs, such as estimates of current credit spreads, to evaluate the likelihood of default by us and the counterparties. As of September 30, 2011, we have assessed the significance of the impact of the credit valuation adjustments on the overall valuation of our derivative positions and have determined that the credit valuation adjustments are not significant to the overall valuation of our derivatives. As a result, we have determined that our derivative valuations in their entirety are classified as level 2 inputs in the fair value hierarchy.

(2) Properties held for sale that were adjusted to fair value at September 30, 2011 includes six office properties and 20 industrial & other properties that we expect to sell within one year. We recorded losses on asset impairment at these properties during the third quarter of 2011 of $9,247 to reduce the carrying value of these properties from $42,280 to their estimated fair value less costs to sell of $33,033. We used negotiated sale prices for 16 properties under agreement for sale, broker information and comparable sales transactions for eight properties (level 2 inputs) and the sum of their expected future discounted cash flows for two properties (level 3 inputs) less estimated closing costs to determine the fair value of these properties. We estimate aggregate future cash flows expected to be generated by each property based on a number of factors such as market rents, operating expenses, discount rates and capitalization rates. These factors are generally based on our experience in local real estate markets and the effects of current market conditions.

COMMONWEALTH REIT

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(dollars in thousands, except per share data)

We are exposed to certain risks relating to our ongoing business operations, including the effect of changes in foreign currency exchange rates and interest rates. The only risk currently managed by using our derivative instruments is a part of our interest rate risk. Although we have not done so as of September 30, 2011 and have no present intention to do so, we may manage our Australian currency exchange exposure by borrowing in Australian dollars or using derivative instruments in the future, depending on the relative significance of our business activities in Australia at that time. We have interest rate swap agreements to manage our interest rate risk exposure on $175,000 of mortgage notes due 2019, which require interest at a spread over LIBOR. The interest rate swap agreements utilized by us qualify as cash flow hedges and effectively modify our exposure to interest rate risk by converting our floating interest rate debt to a fixed interest rate basis for this loan through December 1, 2016, thus reducing the impact of interest rate changes on future interest expense. These agreements involve the receipt of floating interest rate amounts in exchange for fixed rate interest payments over the life of the agreements without an exchange of the underlying principal amount. The fair value of our derivative instruments decreased by $6,577 and $8,651 during the three and nine months ended September 30, 2011, respectively, based primarily on changes in market interest rates. The fair value of our derivative instruments decreased by $5,150 and $15,965 during the three and nine months ended September 30, 2010, respectively, based primarily on changes in market interest rates. As of September 30, 2011 and December 31, 2010, the fair value of these derivative instruments included in accounts payable and accrued expenses and cumulative other comprehensive (loss) income in our consolidated balance sheets totaled ($15,607) and ($6,956), respectively. We may enter additional interest rate swaps or hedge agreements to manage some of our additional interest rate risk associated with our floating rate borrowings.

In addition to the assets and liabilities described in the above table, our financial instruments include our cash and cash equivalents, rents receivable, equity investments, investment in direct financing lease receivable, restricted cash, revolving credit facility, senior notes and mortgage notes payable, accounts payable and accrued expenses, rent collected in advance, security deposits and amounts due to related persons. At September 30, 2011 and December 31, 2010, the fair values of these additional financial instruments were not materially different from their carrying values, except as follows:

	September 30, 2011		December 31, 2010	
	Carrying Amount	**Fair Value**	**Carrying Amount**	**Fair Value**
Equity investment in GOV	$ 173,407	$ 214,025	$ 166,388	$ 266,561
Senior notes and mortgage notes payable	$ 2,746,535	$ 2,885,908	$ 2,462,847	$ 2,599,075

At September 30, 2011 and December 31, 2010, the fair values of our equity investment in GOV are based on quoted market prices of $21.51 and $26.79, respectively. The fair values of our senior notes and mortgage notes payable are based on estimates using discounted cash flow analyses and currently prevailing interest rates adjusted by credit risk spreads.

Other financial instruments that potentially subject us to concentrations of credit risk consist principally of rents receivable; however, no single tenant of ours is responsible for more than 2% of our total rents.

We maintain derivative financial instruments, including interest rate swaps, with major financial institutions and monitor the amount of credit exposure to any one counterparty.

Note 11. Earnings Per Common Share

As of September 30, 2011, we had 15,180,000 shares of series D cumulative convertible preferred shares that were convertible into 7,298,165 of our common shares. The effect of our convertible preferred shares on income from continuing operations available for common shareholders per share is anti-dilutive for the periods presented.

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(dollars in thousands, except per share data)

Note 12. Segment Information

As of September 30, 2011, we owned 44 Central Business District, or CBD, office properties, 266 suburban office properties and 179 industrial & other properties, excluding properties held for sale. We account for all of these properties in geographic operating segments for financial reporting purposes based on our method of internal reporting. We account for our properties by property type (i.e. CBD office, suburban office and industrial & other) and by geographic regions. We define these individual geographic segments as those which currently, or during either of the last two quarters, represent or generate 5% or more of our total square feet, annualized revenues or property net operating income, or NOI, which we define as rental income less operating expenses. Our geographic segments include Metro Philadelphia, PA, Oahu, HI, Metro Chicago, IL, Metro Washington, DC, Metro Denver, CO, Australia and Other Markets, which includes properties located elsewhere throughout the United States. Prior periods have been restated to reflect 30 office properties and 25 industrial & other properties reclassified to discontinued operations during the fourth quarter of 2010 and 12 office properties and one industrial property reclassified to discontinued operations during the third quarter of 2011. Property level information by geographic segment and property type as of and for the three and nine months ended September 30, 2011 and 2010 is as follows:

	As of September 30, 2011				As of September 30, 2010			
	CBD Office	Suburban Office	Industrial & Other	Totals	CBD Office	Suburban Office	Industrial & Other	Totals
Property square feet (in thousands):								
Metro Philadelphia, PA	4,591	462		5,053	4,592	462		5,054
Oahu, HI			17,896	17,896			17,914	17,914
Metro Chicago, IL	2,582	1,164	104	3,850		532	104	636
Metro Washington, DC	428	1,216		1,644	428	1,067		1,495
Metro Denver, CO	672	789	553	2,014	672	788	553	2,013
Australia	314		1,442	1,756				
Other Markets	9,067	17,629	10,490	37,186	6,423	15,582	10,313	32,318
Totals	17,654	21,260	30,485	69,399	12,115	18,431	28,884	59,430

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(dollars in thousands, except per share data)

	Three Months Ended September 30, 2011				Three Months Ended September 30, 2010			
	CBD Office	Suburban Office	Industrial & Other	Totals	CBD Office	Suburban Office	Industrial & Other	Totals
Property rental income:								
Metro Philadelphia, PA	$ 29,169	$ 1,378	$	$ 30,547	$ 27,920	$ 1,872	$	$ 29,792
Oahu, HI			18,190	18,190			18,114	18,114
Metro Chicago, IL	14,272	6,783	111	21,166		3,441	116	3,557
Metro Washington, DC	4,726	8,772		13,498	4,284	7,471		11,755
Metro Denver, CO	4,998	4,005	2,324	11,327	5,238	3,778	2,124	11,140
Australia	5,265		3,230	8,495				
Other Markets	46,569	72,330	16,668	135,567	38,210	63,731	16,760	118,701
Totals	$ 104,999	$ 93,268	$ 40,523	$ 238,790	$ 75,652	$ 80,293	$ 37,114	$ 193,059
Property net operating income:								
Metro Philadelphia, PA	$ 14,854	$ 249	$	$ 15,103	$ 14,112	$ 674	$	$ 14,786
Oahu, HI			13,588	13,588			13,542	13,542
Metro Chicago, IL	8,044	3,683	104	11,831		2,429	101	2,530
Metro Washington, DC	3,942	5,957		9,899	2,747	4,372		7,119
Metro Denver, CO	3,136	3,085	1,191	7,412	3,409	2,773	1,201	7,383
Australia	4,296		2,438	6,734				
Other Markets	22,613	39,667	11,031	73,311	17,727	34,759	12,190	64,676
Totals	$ 56,885	$ 52,641	$ 28,352	$ 137,878	$ 37,995	$ 45,007	$ 27,034	$ 110,036

	Nine Months Ended September 30, 2011				Nine Months Ended September 30, 2010			
	CBD Office	Suburban Office	Industrial & Other	Totals	CBD Office	Suburban Office	Industrial & Other	Totals
Property rental income:								