EASTGROUP PROPERTIES INC
Form 10-Q
October 21, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

FOR THE QUARTER ENDED SEPTEMBER 30, 2013 COMMISSION FILE NUMBER 1-07094

EASTGROUP PROPERTIES, INC.
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

MARYLAND	13-2711135
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

190 EAST CAPITOL STREET SUITE 400 JACKSON, MISSISSIPPI	39201
(Address of principal executive offices)	(Zip code)

Registrant's telephone number: (601) 354-3555

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 ( )

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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES (x) 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 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 ( ) Non-accelerated Filer ( ) 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 ( ) NO (x)

The number of shares of common stock, $.0001 par value, outstanding as of October 18, 2013 was 30,624,490.

EASTGROUP PROPERTIES, INC. AND SUBSIDIARIES

FORM 10-Q

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EASTGROUP PROPERTIES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS, EXCEPT FOR SHARE AND PER SHARE DATA)

	September 30, 2013 (Unaudited)	December 31, 2012
ASSETS		
Real estate properties	$1,761,981	1,619,777
Development	147,489	148,255
	1,909,470	1,768,032
Less accumulated depreciation	(536,332)	(496,247)
	1,373,138	1,271,785
Unconsolidated investment	2,762	2,743
Cash	207	1,258
Other assets	89,540	78,316
TOTAL ASSETS	$1,465,647	1,354,102
LIABILITIES AND EQUITY		
LIABILITIES		
Secured debt	$555,831	607,766
Unsecured debt	230,000	130,000
Unsecured bank credit facilities	111,667	76,160
Accounts payable and accrued expenses	42,333	28,914
Other liabilities	22,132	20,086
Total Liabilities	961,963	862,926
EQUITY		
Stockholders' Equity:		
Common shares; $.0001 par value; 70,000,000 shares authorized; 30,624,490 shares issued and outstanding at September 30, 2013 and 29,928,490 at December 31, 2012	3	3
Excess shares; $.0001 par value; 30,000,000 shares authorized; no shares issued	—	—
Additional paid-in capital on common shares	769,512	731,950
Distributions in excess of earnings	(270,919)	(245,249)
Accumulated other comprehensive income (loss)	351	(392)
Total Stockholders' Equity	498,947	486,312
Noncontrolling interest in joint ventures	4,737	4,864
Total Equity	503,684	491,176
TOTAL LIABILITIES AND EQUITY	$1,465,647	1,354,102

See accompanying Notes to Consolidated Financial Statements (unaudited).

EASTGROUP PROPERTIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
(IN THOUSANDS, EXCEPT PER SHARE DATA)
(UNAUDITED)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
REVENUES				
Income from real estate operations	$51,216	46,686	148,484	139,252
Other income	34	15	220	43
	51,250	46,701	148,704	139,295
EXPENSES				
Expenses from real estate operations	14,587	13,580	41,833	39,912
Depreciation and amortization	16,948	15,335	48,891	46,510
General and administrative	2,589	2,453	8,730	8,105
Acquisition costs	16	45	183	64
	34,140	31,413	99,637	94,591
OPERATING INCOME	17,110	15,288	49,067	44,704
OTHER INCOME (EXPENSE)				
Interest expense	(8,845)	(8,426)	(26,183)	(26,844)
Other	249	(98)	728	245
INCOME FROM CONTINUING OPERATIONS	8,514	6,764	23,612	18,105
DISCONTINUED OPERATIONS				
Income from real estate operations	—	133	—	361
Gain on sales of nondepreciable real estate investments, net of tax	—	—	—	167
Gain on sales of real estate investments	—	—	—	1,869
INCOME FROM DISCONTINUED OPERATIONS	—	133	—	2,397
NET INCOME	8,514	6,897	23,612	20,502
Net income attributable to noncontrolling interest in joint ventures	(151)	(126)	(452)	(356)
NET INCOME ATTRIBUTABLE TO EASTGROUP PROPERTIES, INC. COMMON STOCKHOLDERS	8,363	6,771	23,160	20,146
Other comprehensive income (loss) - cash flow hedge	(1,597)	(605)	743	(605)
TOTAL COMPREHENSIVE INCOME	$6,766	6,166	23,903	19,541
BASIC PER COMMON SHARE DATA FOR NET INCOME ATTRIBUTABLE TO EASTGROUP PROPERTIES, INC. COMMON STOCKHOLDERS				
Income from continuing operations	$0.28	0.23	0.77	0.63
Income from discontinued operations	0.00	0.00	0.00	0.08
Net income attributable to common stockholders	$0.28	0.23	0.77	0.71
Weighted average shares outstanding	30,281	28,912	30,029	28,271
DILUTED PER COMMON SHARE DATA FOR NET INCOME ATTRIBUTABLE TO EASTGROUP PROPERTIES, INC. COMMON STOCKHOLDERS				
Income from continuing operations	$0.28	0.23	0.77	0.63
Income from discontinued operations	0.00	0.00	0.00	0.08
Net income attributable to common stockholders	$0.28	0.23	0.77	0.71
Weighted average shares outstanding	30,400	29,030	30,124	28,361

AMOUNTS ATTRIBUTABLE TO EASTGROUP PROPERTIES, INC. COMMON STOCKHOLDERS				
Income from continuing operations	$8,363	6,638	23,160	17,749
Income from discontinued operations	—	133	—	2,397
Net income attributable to common stockholders	$8,363	6,771	23,160	20,146

See accompanying Notes to Consolidated Financial Statements (unaudited).

EASTGROUP PROPERTIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
(IN THOUSANDS, EXCEPT FOR SHARE AND PER SHARE DATA)
(UNAUDITED)

	Common Stock	Additional Paid-In Capital	Distributions in Excess of Earnings	Accumulated Other Comprehensive Income (Loss)	Noncontrolling Interest in Joint Ventures	Total
BALANCE, DECEMBER 31, 2012	$3	731,950	(245,249)	(392)	4,864	491,176
Net income	—	—	23,160	—	452	23,612
Net unrealized change in fair value of interest rate swap	—	—	—	743	—	743
Common dividends declared – $1.60 per share	—	—	(48,830)	—	—	(48,830)
Stock-based compensation, net of forfeitures	—	4,324	—	—	—	4,324
Issuance of 579,198 shares of common stock, common stock offering, net of expenses	—	33,490	—	—	—	33,490
Issuance of 4,500 shares of common stock, options exercised	—	120	—	—	—	120
Issuance of 2,703 shares of common stock, dividend reinvestment plan	—	156	—	—	—	156
Withheld 9,412 shares of common stock to satisfy tax withholding obligations in connection with the vesting of restricted stock	—	(528)	—	—	—	(528)
Distributions to noncontrolling interest	—	—	—	—	(579)	(579)
BALANCE, SEPTEMBER 30, 2013	$3	769,512	(270,919)	351	4,737	503,684

See accompanying Notes to Consolidated Financial Statements (unaudited).

EASTGROUP PROPERTIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(IN THOUSANDS)
(UNAUDITED)

	Nine Months Ended September 30, 2013	2012
OPERATING ACTIVITIES		
Net income	$23,612	20,502
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization from continuing operations	48,891	46,510
Depreciation and amortization from discontinued operations	—	483
Stock-based compensation expense	3,204	2,781
Gain on sales of land and real estate investments	(24)	(2,036)
Changes in operating assets and liabilities:		
Accrued income and other assets	2,202	2,832
Accounts payable, accrued expenses and prepaid rent	10,765	1,977
Other	(71)	134
NET CASH PROVIDED BY OPERATING ACTIVITIES	88,579	73,183
INVESTING ACTIVITIES		
Real estate development	(61,561)	(34,834)
Purchases of real estate	(72,397)	(10,950)
Real estate improvements	(16,053)	(13,670)
Proceeds from sales of real estate investments	1,313	7,399
Repayments on mortgage loans receivable	78	3
Changes in accrued development costs	2,062	72
Changes in other assets and other liabilities	(9,411)	(6,429)
NET CASH USED IN INVESTING ACTIVITIES	(155,969)	(58,409)
FINANCING ACTIVITIES		
Proceeds from unsecured bank credit facilities	307,725	186,072
Repayments on unsecured bank credit facilities	(272,218)	(294,137)
Proceeds from secured debt	—	54,000

Repayments on secured debt	(51,920)	(68,282)
Proceeds from unsecured debt	100,000	80,000
Debt issuance costs	(1,650)	(1,474)
Distributions paid to stockholders (not including dividends accrued on unvested restricted stock)	(48,252)	(45,035)
Proceeds from common stock offerings	33,490	74,903
Proceeds from exercise of stock options	120	108
Proceeds from dividend reinvestment plan	156	168
Other	(1,112)	(244)
NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES	66,339	(13,921)
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(1,051)	853
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	1,258	174
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$207	1,027
SUPPLEMENTAL CASH FLOW INFORMATION		
Cash paid for interest, net of amount capitalized of $3,841 and $3,362 for 2013 and 2012, respectively	$24,852	26,162

See accompanying Notes to Consolidated Financial Statements (unaudited).

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EASTGROUP PROPERTIES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

(1) BASIS OF PRESENTATION

The accompanying unaudited financial statements of EastGroup Properties, Inc. ("EastGroup" or "the Company") have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In management's opinion, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. The financial statements should be read in conjunction with the financial statements contained in the 2012 annual report on Form 10-K and the notes thereto.

Certain reclassifications have been made in the 2012 consolidated financial statements to conform to the 2013 presentation.

(2) PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of EastGroup, its wholly-owned subsidiaries and its investment in any joint ventures in which the Company has a controlling interest. At September 30, 2013 and December 31, 2012, the Company had a controlling interest in two joint ventures: the 80% owned University Business Center and the 80% owned Castilian Research Center. The Company records 100% of the joint ventures' assets, liabilities, revenues and expenses with noncontrolling interests provided for in accordance with the joint venture agreements. The equity method of accounting is used for the Company's 50% undivided tenant-in-common interest in Industry Distribution Center II. All significant intercompany transactions and accounts have been eliminated in consolidation.

(3) USE OF ESTIMATES

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and revenues and expenses during the reporting period and to disclose material contingent assets and liabilities at the date of the financial statements. Actual results could differ from those estimates.

(4) REAL ESTATE PROPERTIES

EastGroup has one reportable segment – industrial properties. These properties are concentrated in major Sunbelt markets of the United States, primarily in the states of Florida, Texas, Arizona, California and North Carolina, have similar economic characteristics and also meet the other criteria permitting the properties to be aggregated into one reportable segment.

The Company reviews long-lived assets for impairment whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted net cash flows (including estimated future expenditures necessary to substantially complete the asset) expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized for the amount by which the carrying amount of the asset exceeds the fair value of the asset. As of September 30, 2013 and December 31, 2012, the Company determined that no impairment charges on the Company's real estate properties were necessary.

Depreciation of buildings and other improvements is computed using the straight-line method over estimated useful lives of generally 40 years for buildings and 3 to 15 years for improvements. Building improvements are capitalized, while maintenance and repair expenses are charged to expense as incurred. Significant renovations and improvements that improve or extend the useful life of the assets are capitalized. Depreciation expense for continuing and discontinued operations was $13,826,000 and $40,377,000 for the three and nine months ended September 30, 2013, respectively, and $12,814,000 and $38,791,000 for the same periods in 2012.

EASTGROUP PROPERTIES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The Company's real estate properties at September 30, 2013 and December 31, 2012 were as follows:

	September 30, 2013	December 31, 2012
	(In thousands)	
Real estate properties:		
Land	$264,687	244,199
Buildings and building improvements	1,199,942	1,102,597
Tenant and other improvements	297,352	272,981
Development	147,489	148,255
	1,909,470	1,768,032
Less accumulated depreciation	(536,332)	(496,247)
	$1,373,138	1,271,785

(5) DEVELOPMENT

During the period in which a property is under development, costs associated with development (i.e., land, construction costs, interest expense, property taxes and other direct and indirect costs associated with development) are aggregated into the total capitalized costs of the property. Included in these costs are management's estimates for the portions of internal costs (primarily personnel costs) deemed directly or indirectly related to such development activities. The internal costs are allocated to specific development properties based on construction activity. As the property becomes occupied, depreciation commences on the occupied portion of the building, and costs are capitalized only for the portion of the building that remains vacant. When the property becomes 80% occupied or one year after completion of the shell construction (whichever comes first), capitalization of development costs ceases. The properties are then transferred to real estate properties, and depreciation commences on the entire property (excluding the land).

(6) BUSINESS COMBINATIONS AND ACQUIRED INTANGIBLES

Upon acquisition of real estate properties, the Company applies the principles of Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 805, Business Combinations, which requires that acquisition-related costs be recognized as expenses in the periods in which the costs are incurred and the services are received. The Codification also provides guidance on how to properly determine the allocation of the purchase price among the individual components of both the tangible and intangible assets based on their respective fair values. Goodwill is recorded when the purchase price exceeds the fair value of the assets and liabilities acquired. Factors considered by management in allocating the cost of the properties acquired include an estimate of carrying costs during the expected lease-up periods considering current market conditions and costs to execute similar leases. The allocation to tangible assets (land, building and improvements) is based upon management's determination of the value of the property as if it were vacant using discounted cash flow models. The Company determines whether any financing assumed is above or below market based upon comparison to similar financing terms for similar properties. The cost of the properties acquired may be adjusted based on indebtedness assumed from the seller that is determined to be above or below market rates.

The purchase price is also allocated among the following categories of intangible assets: the above or below market component of in-place leases, the value of in-place leases, and the value of customer relationships. The value allocable to the above or below market component of an acquired in-place lease is determined based upon the present value (using a discount rate reflecting the risks associated with the acquired leases) of the difference between (i) the contractual amounts to be paid pursuant to the lease over its remaining term, and (ii) management's estimate of the amounts that would be paid using fair market rates over the remaining term of the lease. The amounts allocated to above and below market leases are included in Other Assets and Other Liabilities, respectively, on the Consolidated Balance Sheets and are amortized to rental income over the remaining terms of the respective leases. The total amount of intangible assets is further allocated to in-place lease values and customer relationship values based upon management's assessment of their respective values. These intangible assets are included in Other Assets on the Consolidated Balance Sheets and are amortized over the remaining term of the existing lease, or the anticipated life of the customer relationship, as applicable.

Amortization expense for in-place lease intangibles was $1,284,000 and $3,061,000 for the three and nine months ended September 30, 2013, respectively, and $881,000 and $2,927,000 for the same periods in 2012. Amortization of above and below market leases increased rental income by $93,000 and $68,000 for the three and nine months ended September 30, 2013, respectively, and decreased rental income by $91,000 and $325,000 for the same periods in 2012.

EASTGROUP PROPERTIES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

During the first nine months of 2013, EastGroup acquired Northfield Distribution Center in Dallas, Texas, and Interchange Park II in Charlotte, North Carolina. The Company purchased these properties for a total cost of $72,397,000, of which $65,387,000 was allocated to real estate properties. The Company allocated $13,218,000 of the total purchase price to land using third party land valuations for the Dallas market. The market values are considered to be Level 3 inputs as defined by ASC 820, Fair Value Measurements and Disclosures (see Note 17 for additional information on ASC 820). Intangibles associated with the purchase of real estate were allocated as follows: $8,399,000 to in-place lease intangibles, $158,000 to above market leases (both included in Other Assets on the Consolidated Balance Sheets), and $1,547,000 to below market leases (included in Other Liabilities on the Consolidated Balance Sheets). These costs are amortized over the remaining lives of the associated leases in place at the time of acquisition.

During the year ended December 31, 2012, the Company acquired Madison Distribution Center in Tampa, Florida; Wiegman Distribution Center II in Hayward, California; and Valwood Distribution Center in Dallas, Texas. The Company purchased these properties for a total cost of $51,750,000, of which $48,934,000 was allocated to real estate properties. The Company allocated $7,435,000 of the total purchase price to land using third party land valuations for the Tampa, Hayward and Dallas markets. Intangibles associated with the purchase of real estate were allocated as follows: $3,305,000 to in-place lease intangibles, $244,000 to above market leases (both included in Other Assets on the Consolidated Balance Sheets), and $733,000 to below market leases (included in Other Liabilities on the Consolidated Balance Sheets).

EastGroup expensed acquisition-related costs of $16,000 and $183,000 during the three and nine months ended September 30, 2013, respectively. The Company expensed $45,000 and $64,000 during the three and nine months ended September 30, 2012.

The Company periodically reviews the recoverability of goodwill (at least annually) and the recoverability of other intangibles (on a quarterly basis) for possible impairment. In management's opinion, no impairment of goodwill and other intangibles existed at September 30, 2013 and December 31, 2012.

(7) REAL ESTATE HELD FOR SALE/DISCONTINUED OPERATIONS

The Company considers a real estate property to be held for sale when it meets the criteria established under ASC 360, Property, Plant, and Equipment, including when it is probable that the property will be sold within a year. Real estate properties held for sale are reported at the lower of the carrying amount or fair value less estimated costs to sell and are not depreciated while they are held for sale. In accordance with the guidelines established under the Codification, the results of operations for the operating properties sold or held for sale during the reported periods are shown under Discontinued Operations on the Consolidated Statements of Income and Comprehensive Income. Interest expense is not generally allocated to the properties held for sale or whose operations are included under Discontinued Operations unless the mortgage is required to be paid in full upon the sale of the property.

The Company did not sell any operating properties during the first nine months of 2013. During the first quarter of 2012, EastGroup's taxable REIT subsidiary sold two properties in Tampa, which collectively contain 10,500 square feet, for $578,000 and recognized an after-tax gain of $167,000. During the second quarter of 2012, the Company sold one operating property (174,000 square feet) in Phoenix for $7,019,000 and recognized a gain of $1,869,000. Additionally, later in 2012, the Company sold one operating property (259,000 square feet) in Tulsa for $10,300,000 and recognized a gain of $4,474,000.

The following table presents the components of revenue and expense for the properties sold or held for sale during 2013 and 2012.

DISCONTINUED OPERATIONS	Three Months Ended September 30, 2013	2012	Nine Months Ended September 30, 2013	2012
	(In thousands)			
Income from real estate operations	$—	296	—	1,129
Expenses from real estate operations	—	(62)	—	(285)
Property net operating income from discontinued operations	—	234	—	844
Depreciation and amortization	—	(101)	—	(483)
Income from real estate operations	—	133	—	361
Gain on sales of nondepreciable real estate investments, net of tax	—	—	—	167
Gain on sales of real estate investments	—	—	—	1,869
Income from discontinued operations	$—	133	—	2,397

EASTGROUP PROPERTIES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

(8) OTHER ASSETS

A summary of the Company's Other Assets follows:

	September 30, 2013	December 31, 2012
	(In thousands)	
Leasing costs (principally commissions)	$46,407	41,290
Accumulated amortization of leasing costs	(18,242)	(17,543)
Leasing costs (principally commissions), net of accumulated amortization	28,165	23,747
Straight-line rents receivable	23,263	22,153
Allowance for doubtful accounts on straight-line rents receivable	(388)	(409)
Straight-line rents receivable, net of allowance for doubtful accounts	22,875	21,744
Accounts receivable	3,365	3,477
Allowance for doubtful accounts on accounts receivable	(320)	(373)
Accounts receivable, net of allowance for doubtful accounts	3,045	3,104
Acquired in-place lease intangibles	17,300	11,848
Accumulated amortization of acquired in-place lease intangibles	(4,628)	(4,516)
Acquired in-place lease intangibles, net of accumulated amortization	12,672	7,332
Acquired above market lease intangibles	1,893	2,443
Accumulated amortization of acquired above market lease intangibles	(613)	(976)
Acquired above market lease intangibles, net of accumulated amortization	1,280	1,467
Mortgage loans receivable	9,278	9,357
Discount on mortgage loans receivable	(25)	(34)
Mortgage loans receivable, net of discount	9,253	9,323
Loan costs	8,120	8,476
Accumulated amortization of loan costs	(3,919)	(4,960)
Loan costs, net of accumulated amortization	4,201	3,516
Interest rate swap assets	1,274	—
Receivable for development infrastructure cost reimbursements	1,199	—
Goodwill	990	990
Prepaid expenses and other assets	4,586	7,093
Total Other Assets	$89,540	78,316

EASTGROUP PROPERTIES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

(9) ACCOUNTS PAYABLE AND ACCRUED EXPENSES

A summary of the Company’s Accounts Payable and Accrued Expenses follows:

	September 30, 2013	December 31, 2012
	(In thousands)	
Property taxes payable	$20,335	12,107
Development costs payable	9,232	7,170
Interest payable	2,998	2,615
Dividends payable on unvested restricted stock	1,769	1,191
Other payables and accrued expenses	7,999	5,831
Total Accounts Payable and Accrued Expenses	$42,333	28,914

(10) OTHER LIABILITIES

A summary of the Company’s Other Liabilities follows:

	September 30, 2013	December 31, 2012
	(In thousands)	
Security deposits	$10,934	9,668
Prepaid rent and other deferred income	7,557	7,930
Acquired below-market lease intangibles	2,999	1,541
Accumulated amortization of below-market lease intangibles	(714)	(391)
Acquired below-market lease intangibles, net of accumulated amortization	2,285	1,150
Interest rate swap liabilities	1,116	645
Other liabilities	240	693
Total Other Liabilities	$22,132	20,086

(11) COMPREHENSIVE INCOME

Total Comprehensive Income is comprised of net income plus all other changes in equity from non-owner sources and is presented on the Consolidated Statements of Income and Comprehensive Income. The components of Accumulated Other Comprehensive Income (Loss) are presented in the Company's Consolidated Statement of Changes in Equity and are summarized below. See Note 12 for information regarding the Company's interest rate swaps.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	(In thousands)			
ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS):				
Balance at beginning of period	$1,948	—	(392)	—
Change in fair value of interest rate swaps	(1,597)	(605)	743	(605)
Balance at end of period	$351	(605)	351	(605)

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EASTGROUP PROPERTIES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

(12) DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

The Company is exposed to certain risks arising from both its business operations and economic conditions. The Company principally manages its exposures to a wide variety of business and operational risks through management of its core business activities. The Company manages economic risk, including interest rate, liquidity and credit risk primarily by managing the amount, sources, and duration of its debt funding and, to a limited extent, the use of derivative instruments.

Specifically, the Company has entered into derivative instruments to manage exposures that arise from business activities that result in the payment of future known and uncertain cash amounts, the value of which are determined by interest rates. The Company's derivative instruments, described below, are used to manage differences in the amount, timing and duration of the Company's known or expected cash payments principally related to certain of the Company's borrowings.

The Company's objective in using interest rate derivatives is to manage exposure to interest rate movements and add stability to interest expense. To accomplish this objective, the Company uses interest rate swaps as part of its interest rate risk management strategy. Interest rate swaps designated as cash flow hedges involve the receipt of variable-rate amounts from a counterparty in exchange for the Company making fixed-rate payments over the life of the agreements without exchange of the underlying notional amount.

The Company currently has three interest rate swaps outstanding, all of which are used to hedge the variable cash flows associated with unsecured loans. The Company executed one $80,000,000 interest rate swap associated with an $80,000,000 unsecured loan during the third quarter of 2012. The interest rate swap converts the loan's LIBOR rate component to a fixed interest rate for the entire term of the loan, and the Company has concluded that the hedging relationship is highly effective. During the third quarter of 2013, the Company entered into two forward starting interest rate swaps totaling $75,000,000 which are hedging an unsecured loan which is expected to close in December 2013; the swaps convert the loan's LIBOR rate component to a fixed interest rate for the entire term of the loan, and the Company has concluded that the hedging relationships are highly effective.

The effective portion of changes in the fair value of derivatives designated and qualifying as cash flow hedges is recorded in Other Comprehensive Income and is subsequently reclassified into earnings in the period that the hedged forecasted transaction affects earnings. The ineffective portion of the change in fair value of the derivatives, which is immaterial for the periods reported, is recognized directly in earnings (included in Other on the Consolidated Statements of Income and Comprehensive Income).

Amounts reported in Other Comprehensive Income related to derivatives will be reclassified to Interest Expense as interest payments are made on the Company's variable-rate debt. The Company estimates that an additional $1,830,000 will be reclassified from Other Comprehensive Income as an increase to Interest Expense over the next twelve months.

As of January 1, 2013, the Company changed its valuation methodology for over-the-counter (“OTC”) derivatives to discount cash flows based on Overnight Index Swap (“OIS”) rates. Uncollateralized or partially-collateralized trades are discounted at OIS, but include appropriate economic adjustments for funding costs (i.e., a LIBOR-OIS basis adjustment to approximate uncollateralized cost of funds) and credit risk. The Company made the changes to better align its inputs, assumptions, and pricing methodologies with those used in its principal market by most dealers and major market participants. The changes in valuation methodology were applied prospectively as a change in accounting estimate and are immaterial to the Company's financial statements.

As of September 30, 2013 and December 31, 2012, the Company had the following outstanding interest rate derivatives that are designated as cash flow hedges of interest rate risk:

Interest Rate Derivative	Notional Amount as of September 30, 2013	Notional Amount as of December 31, 2012
Interest Rate Swap	$80,000,000	$80,000,000
Interest Rate Swap	$60,000,000	—
Interest Rate Swap	$15,000,000	—

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The table below presents the fair value of the Company's derivative financial instruments as well as their classification on the Consolidated Balance Sheets as of September 30, 2013 and December 31, 2012. See Note 17 for additional information on the fair value of the Company's interest rate swaps.

	Derivatives As of September 30, 2013		Derivatives As of December 31, 2012	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives designated as cash flow hedges:				
Interest rate swap assets	Other Assets	$1,274,000	Other Assets	$—
Interest rate swap liabilities	Other Liabilities	1,116,000	Other Liabilities	645,000

The table below presents the effect of the Company's derivative financial instruments on the Consolidated Statements of Income and Comprehensive Income for the three and nine months ended September 30, 2013 and 2012:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	(In thousands)			
DERIVATIVES IN CASH FLOW HEDGING RELATIONSHIPS				
Interest Rate Swaps:				
Amount of income (loss) recognized in Other Comprehensive Income on derivative	$(1,755)	(655)	284	(655)
Amount of loss reclassified from Accumulated Other Comprehensive Income (Loss) into Interest Expense	(156)	(50)	(457)	(50)
MARK TO MARKET DERIVATIVES				
Interest Rate Swaps:				
Amount of loss recognized in earnings upon swap designation	—	(242)	—	(242)

See Note 11 for additional information on the Company's Accumulated Other Comprehensive Income (Loss) resulting from its interest rate swaps.

Derivative financial agreements expose the Company to credit risk in the event of non-performance by the counterparties under the terms of the interest rate hedge agreements. The Company believes it minimizes the credit risk by transacting with major credit-worthy financial institutions.

The Company has an agreement with its derivative counterparty containing a provision stating that the Company could be declared in default on its derivative obligations if the Company defaults on any of its indebtedness, including default where repayment of the indebtedness has not been accelerated by the lender.

As of September 30, 2013, the fair value of derivatives in an asset position related to these agreements was $1,274,000, and the fair value of derivatives in a liability position related to these agreements was $1,116,000. If the Company breached any of the contractual provisions of the derivative contracts, it would be required to settle its obligation under the agreements at the swap termination value. As of September 30, 2013, the swap termination value of derivatives in an asset position was an asset in the amount of $1,321,000, and the swap termination value of derivatives in a liability position was a liability in the amount of $1,016,000.

(13) EARNINGS PER SHARE

The Company applies ASC 260, Earnings Per Share, which requires companies to present basic and diluted earnings per share (EPS). Basic EPS represents the amount of earnings for the period attributable to each share of common stock outstanding during the reporting period. The Company's basic EPS is calculated by dividing net income attributable to common stockholders by the weighted average number of common shares outstanding.

Diluted EPS represents the amount of earnings for the period attributable to each share of common stock outstanding during the reporting period and to each share that would have been outstanding assuming the issuance of common shares for all dilutive potential common shares outstanding during the reporting period. The Company calculates diluted EPS by dividing net income attributable to common stockholders by the weighted average number of common shares outstanding plus the dilutive effect of unvested restricted stock and stock options had the options been exercised. The dilutive effect of stock options and their equivalents

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(such as unvested restricted stock) is determined using the treasury stock method which assumes exercise of the options as of the beginning of the period or when issued, if later, and assumes proceeds from the exercise of options are used to purchase common stock at the average market price during the period.

Reconciliation of the numerators and denominators in the basic and diluted EPS computations is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	(In thousands)			
BASIC EPS COMPUTATION FOR NET INCOME ATTRIBUTABLE TO EASTGROUP PROPERTIES, INC. COMMON STOCKHOLDERS				
Numerator – net income attributable to common stockholders	$8,363	6,771	23,160	20,146
Denominator – weighted average shares outstanding	30,281	28,912	30,029	28,271
DILUTED EPS COMPUTATION FOR NET INCOME ATTRIBUTABLE TO EASTGROUP PROPERTIES, INC. COMMON STOCKHOLDERS				
Numerator – net income attributable to common stockholders	$8,363	6,771	23,160	20,146
Denominator:				
Weighted average shares outstanding	30,281	28,912	30,029	28,271
Common stock options	—	2	1	3
Unvested restricted stock	119	116	94	87
Total Shares	30,400	29,030	30,124	28,361

(14) STOCK-BASED COMPENSATION

Equity Incentive Plan
In May 2004, the stockholders of the Company approved the EastGroup Properties, Inc. 2004 Equity Incentive Plan (the “2004 Plan”) that authorized the issuance of up to 1,900,000 shares of common stock to employees in the form of options, stock appreciation rights, restricted stock, deferred stock units, performance shares, bonus stock or stock in lieu of cash compensation. The 2004 Plan was further amended by the Board of Directors in September 2005 and December 2006.

In April 2013, the Board of Directors adopted the EastGroup Properties, Inc. 2013 Equity Incentive Plan (the “2013 Equity Plan”) upon the recommendation of the Compensation Committee; the 2013 Equity Plan was approved by the Company's stockholders and became effective May 29, 2013. The 2013 Equity Plan replaced the 2004 Plan and the 2005 Directors Equity Incentive Plan. The 2013 Equity Plan permits the grant of awards to employees and directors with respect to 2,000,000 shares of common stock. Total shares available for grant were 1,972,138 at September 30, 2013. Typically, the Company issues new shares to fulfill stock grants.
Stock-based compensation cost was $1,066,000 and $3,905,000 for the three and nine months ended September 30, 2013, respectively, of which $294,000 and $986,000 were capitalized as part of the Company’s development costs. For the three and nine months ended September 30, 2012, stock-based compensation cost was $870,000 and $3,210,000,

respectively, of which $212,000 and $669,000 were capitalized as part of the Company's development costs.

Equity Awards

In the second quarter of 2013, the Company’s Board of Directors approved an equity incentive plan for its executive officers based upon the attainment of certain annual performance goals. These goals are for the year ending December 31, 2013, so any shares issued upon attainment of these goals will be issued after that date. The number of shares to be issued could range from zero to 42,780. These shares will vest 20% on the date shares are determined and awarded and generally will vest 20% per year on each January 1 for the subsequent four years.

Also in the second quarter of 2013, EastGroup's Board of Directors approved a long-term equity compensation plan for the Company’s executive officers. The awards will be based on the results of the Company's total shareholder return, both on an absolute basis for 2013 as well as on a relative basis compared to the NAREIT Equity Index, NAREIT Industrial Index and Russell 2000 Index over the five-year period ending December 31, 2013. Any shares issued pursuant to this plan will be issued after December 31, 2013. The number of shares issued could range from zero to 45,288. These shares will vest 25% on the date shares are determined and awarded and generally will vest 25% per year on each January 1 for the subsequent three years.

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Notwithstanding the foregoing, shares issued to the Company’s Chief Executive Officer, David H. Hoster II, and Chief Financial Officer, N. Keith McKey, will become fully vested no later than January 1, 2016 and April 6, 2016, respectively.

During the third quarter of 2013, 20,950 shares were granted to certain non-executive officers subject only to continued service as of the vesting date. These shares, which have a grant date fair value of $55.34 per share, will vest 20% per year on January 1 in years 2014, 2015, 2016, 2017 and 2018.

Following is a summary of the total restricted shares granted, forfeited and delivered (vested) to employees with the related weighted average grant date fair value share prices. Of the shares that vested in the first nine months of 2013, the Company withheld 17,927 shares to satisfy the tax obligations for those employees who elected this option as permitted under the applicable equity plan. As of the vesting date, the fair value of shares that vested during the first nine months of 2013 was $1,700,000.

Award Activity:	Three Months Ended September 30, 2013		Nine Months Ended September 30, 2013	
	Shares	Weighted Average Grant Date Fair Value	Shares	Weighted Average Grant Date Fair Value
Unvested at beginning of period	273,039	$46.55	212,206	$42.84
Granted	20,950	55.34	112,099	56.77
Forfeited	—	—	—	—
Vested	—	—	(30,316)	52.32
Unvested at end of period	293,989	$47.17	293,989	$47.17

Directors Equity Plan
The Company previously had a directors equity plan that was approved by stockholders and adopted in 2005 (the "2005 Plan"), which authorized the issuance of up to 50,000 shares of common stock through awards of shares and restricted shares granted to non-employee directors of the Company. The 2005 Plan was further amended by the Board of Directors in May 2006, May 2008, May 2011 and May 2012. The 2005 Plan was replaced by the 2013 Equity Plan effective May 29, 2013, and the Board of Directors has adopted a policy under the 2013 Equity Plan pursuant to which awards will be made to non-employee Directors. The current policy provides that the Company shall automatically award an annual retainer share award to each non-employee Director who has been elected or reelected as a member of the Board of Directors at the Annual Meeting. The number of shares shall be equal to $70,000 divided by the fair market value of a share on the date of such election. If a non-employee Director is elected or appointed to the Board of Directors other than at an Annual Meeting of the Company, the annual retainer share award shall be pro rated. The policy also provides that each new non-employee Director appointed or elected will receive an automatic award of restricted shares of Common Stock on the effective date of election or appointment equal to $25,000 divided by the fair market value of the Company's Common Stock on such date. These restricted shares will vest over a four-year period upon the performance of future service as a Director, subject to certain exceptions. Stock-based compensation expense for directors was $105,000 and $285,000 for the three and nine months ended September 30, 2013, respectively, and $90,000 and $240,000 for the same periods in 2012.

(15) RISKS AND UNCERTAINTIES

The state of the overall economy can significantly impact the Company’s operational performance and thus impact its financial position. Should EastGroup experience a significant decline in operational performance, it may affect the

Company's ability to make distributions to its shareholders, service debt, or meet other financial obligations.

(16) RECENT ACCOUNTING PRONOUNCEMENTS

EastGroup has evaluated all Accounting Standards Updates (ASUs) released by the FASB through the date the financial statements were issued and determined that the following ASUs apply to the Company.

In February 2013, the FASB issued ASU 2013-02, Comprehensive Income (Topic 220) Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income, which requires an entity to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required under GAAP to be reclassified in its entirety to net income. For other amounts that are not required under GAAP to be reclassified in their entirety to net income in the same reporting period, an entity is required to cross-reference other disclosures required under GAAP that provide detail about those amounts. ASU 2013-02 was effective for interim and annual reporting periods beginning after December 15, 2012. The Company has adopted the provisions of ASU 2013-02 and provided the necessary disclosures beginning with the period ended March 31, 2013.

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(17) FAIR VALUE OF FINANCIAL INSTRUMENTS

ASC 820, Fair Value Measurements and Disclosures, defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC 820 also provides guidance for using fair value to measure financial assets and liabilities. The Codification requires disclosure of the level within the fair value hierarchy in which the fair value measurements fall, including measurements using quoted prices in active markets for identical assets or liabilities (Level 1), quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in markets that are not active (Level 2), and significant valuation assumptions that are not readily observable in the market (Level 3).

The following table presents the carrying amounts and estimated fair values of the Company's financial instruments in accordance with ASC 820 at September 30, 2013 and December 31, 2012.

	September 30, 2013		December 31, 2012	
	Carrying Amount (1)	Fair Value	Carrying Amount (1)	Fair Value
	(In thousands)			
Financial Assets:				
Cash and cash equivalents	$207	207	1,258	1,258
Mortgage loans receivable, net of discount	9,253	9,461	9,323	9,748
Interest rate swap assets	1,274	1,274	—	—
Financial Liabilities:				
Secured debt	555,831	581,125	607,766	661,408
Unsecured debt	230,000	222,378	130,000	130,776
Unsecured bank credit facilities	111,667	111,776	76,160	76,160
Interest rate swap liabilities	1,116	1,116	645	645

(1) Carrying amounts shown in the table are included in the Consolidated Balance Sheets under the indicated captions, except as explained in the notes below.

The following methods and assumptions were used to estimate the fair value of each class of financial instruments:
Cash and cash equivalents: The carrying amounts approximate fair value due to the short maturity of those instruments.
Mortgage loans receivable, net of discount (included in Other Assets on the Consolidated Balance Sheets): The fair value is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities (Level 2 input).
Interest rate swap assets (included in Other Assets on the Consolidated Balances Sheets): The instrument is recorded at fair value based on models using inputs, such as interest rate yield curves, LIBOR swap curves and OIS curves, observable for substantially the full term of the contract (Level 2 input). See Note 12 for additional information on the Company's interest rate swap.
Secured debt: The fair value of the Company's secured fixed rate debt is estimated by discounting expected cash flows at the rates currently offered to the Company for debt of the same remaining maturities, as advised by the Company's bankers (Level 2 input).
Unsecured debt: The fair value of the Company's unsecured fixed rate debt is estimated by discounting expected cash flows at the rates currently offered to the Company for debt of the same remaining maturities, as advised by the Company's bankers (Level 2 input).

Unsecured bank credit facilities: The fair value of the Company’s unsecured bank credit facilities is estimated by discounting expected cash flows at current market rates (Level 2 input).
Interest rate swap liabilities (included in Other Liabilities on the Consolidated Balances Sheets): The instrument is recorded at fair value based on models using inputs, such as interest rate yield curves, LIBOR swap curves and OIS curves, observable for substantially the full term of the contract (Level 2 input). See Note 12 for additional information on the Company's interest rate swaps.

(18) SUBSEQUENT EVENTS

In September 2013, EastGroup negotiated terms for a $75 million unsecured term loan which is expected to close in December 2013. The loan will have a seven year term and interest only payments; it will bear interest at the annual rate of LIBOR plus an applicable margin (currently 1.4%) based on the Company's current senior unsecured long-term debt rating. The Company entered into two interest rate swap agreements to convert the loan's LIBOR rate component to a fixed interest rate for the entire term of the loan providing a total effective fixed interest rate of 3.765% on $60 million and 3.7% on $15 million.

In addition, subsequent to September 30, 2013, the Company began construction of Rampart IV, a 84,000 square foot business distribution building in Denver with a projected total cost of $8.3 million.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

OVERVIEW

EastGroup's goal is to maximize shareholder value by being the leading provider in its markets of functional, flexible and quality business distribution space for location sensitive tenants primarily in the 5,000 to 50,000 square foot range. The Company acquires, develops and operates distribution facilities, the majority of which are clustered around major transportation features in supply constrained submarkets in major Sunbelt regions. The Company's core markets are in the states of Florida, Texas, Arizona, California and North Carolina.

The Company believes its current operating cash flow and lines of credit provide the capacity to fund the operations of the Company for the next twelve months. The Company also believes it can issue common and/or preferred equity and obtain financing from insurance companies and financial institutions. The continuous equity program provided net proceeds to the Company of $33.5 million in the first nine months of 2013, as described in Liquidity and Capital Resources. Also, the Company closed the previously announced private placement issuance of $100 million of senior unsecured notes at a fixed interest rate of 3.8%. This transaction is further discussed in Liquidity and Capital Resources.

The Company's primary revenue is rental income; as such, EastGroup's primary challenge is leasing space. During the nine months ended September 30, 2013, leases expired on 4,836,000 square feet (15.0% of EastGroup's total square footage of 30,298,000), and the Company was successful in renewing or re-leasing 83% of the expiring square feet. In addition, EastGroup leased 1,584,000 square feet of other vacant space during this period. During the first nine months of 2013, average rental rates on new and renewal leases increased by 1.6%. Property net operating income (PNOI) from same properties, defined as operating properties owned during the entire current period and prior year reporting period, increased 2.2% for the quarter ended September 30, 2013, as compared to the same quarter in 2012. For the nine months ended September 30, 2013, PNOI from same properties increased 1.1% as compared to the same period last year.

EastGroup's total leased percentage was 96.3% at September 30, 2013, compared to 95.0% at September 30, 2012. Leases scheduled to expire for the remainder of 2013 were 2.0% of the portfolio on a square foot basis at September 30, 2013, and this figure was reduced to 1.4% as of October 18, 2013.

The Company generates new sources of leasing revenue through its acquisition and development programs. During the first nine months of 2013, the Company closed two operating property acquisitions (nine buildings totaling 837,000 square feet) in Dallas and Charlotte for $72,397,000 and 50.9 acres of development land in Charlotte and San Antonio for $6,567,000. EastGroup continues to see targeted development as a contributor to the Company's long-term growth. The Company mitigates risks associated with development through a Board-approved maximum level of land held for development and by adjusting development start dates according to leasing activity. During the first nine months of 2013, the Company began construction of 12 development projects containing 1,093,000 square feet in Houston, San Antonio, Orlando, Charlotte and Phoenix. EastGroup also transferred 12 properties (810,000 square feet) in Houston, San Antonio and Orlando from its development program to real estate properties with costs of $57.3 million at the date of transfer. As of September 30, 2013, EastGroup's development program consisted of 14 projects (1,339,000 square feet) located in Houston, San Antonio, Orlando, Charlotte and Phoenix. The projected total cost for the development projects, which were collectively 55% leased as of October 18, 2013, is $91.4 million, of which $40.2 million remained to be invested as of September 30, 2013.

Typically, the Company initially funds its acquisition and development programs through its $250 million lines of credit (as discussed in Liquidity and Capital Resources). As market conditions permit, EastGroup issues equity and/or employs fixed-rate debt to replace short-term bank borrowings. In January 2013, Fitch affirmed the Company's credit rating of BBB, and Moody's assigned the Company a credit rating of Baa2. The Company intends to obtain primarily unsecured fixed rate debt in the future. The Company may also access the public debt market in the future as a means to raise capital.

EastGroup has one reportable segment – industrial properties. These properties are primarily located in major Sunbelt regions of the United States, have similar economic characteristics and also meet the other criteria permitting the properties to be aggregated into one reportable segment. The Company’s chief decision makers use two primary measures of operating results in making decisions: (1) property net operating income (PNOI), defined as income from real estate operations less property operating expenses (excluding interest expense, depreciation expense on buildings and improvements, and amortization expense on capitalized leasing costs and in-place lease intangibles), and (2) funds from operations attributable to common stockholders (FFO), defined as net income (loss) attributable to common stockholders computed in accordance with U.S. generally accepted accounting principles (GAAP), excluding gains or losses from sales of depreciable real estate property and impairment losses, plus real estate related depreciation and amortization, and after adjustments for unconsolidated partnerships and joint ventures. The Company calculates FFO based on the National Association of Real Estate Investment Trusts’ (NAREIT) definition.

PNOI is a supplemental industry reporting measurement used to evaluate the performance of the Company's real estate investments. The Company believes the exclusion of depreciation and amortization in the industry's calculation of PNOI provides a supplemental indicator of the properties' performance since real estate values have historically risen or fallen with market conditions. PNOI as calculated by the Company may not be comparable to similarly titled but differently calculated measures for other real estate investment trusts (REITs). The major factors influencing PNOI are occupancy levels, acquisitions and sales, development properties that achieve stabilized operations, rental rate increases or decreases, and the recoverability of operating expenses. The Company's success depends largely upon its ability to lease space and to recover from tenants the operating costs associated with those leases.

PNOI is comprised of Income from real estate operations, less Expenses from real estate operations. PNOI was calculated as follows for the three and nine months ended September 30, 2013 and 2012.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	(In thousands)			
Income from real estate operations	$51,216	46,686	148,484	139,252
Expenses from real estate operations	(14,587)	(13,580)	(41,833)	(39,912)
PROPERTY NET OPERATING INCOME	$36,629	33,106	106,651	99,340

Income from real estate operations is comprised of rental income, expense reimbursement pass-through income and other real estate income including lease termination fees. Expenses from real estate operations is comprised of property taxes, insurance, utilities, repair and maintenance expenses, management fees, other operating costs and bad debt expense. Generally, the Company's most significant operating expenses are property taxes and insurance. Tenant leases may be net leases in which the total operating expenses are recoverable, modified gross leases in which some of the operating expenses are recoverable, or gross leases in which no expenses are recoverable (gross leases represent only a small portion of the Company's total leases). Increases in property operating expenses are fully recoverable under net leases and recoverable to a high degree under modified gross leases. Modified gross leases often include base year amounts and expense increases over these amounts are recoverable. The Company's exposure to property operating expenses is primarily due to vacancies and leases for occupied space that limit the amount of expenses that can be recovered.

The following table presents reconciliations of Net Income to PNOI for the three and nine months ended September 30, 2013 and 2012.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	(In thousands)			
NET INCOME	$8,514	6,897	23,612	20,502
Interest income	(133)	(82)	(401)	(248)
Equity in earnings of unconsolidated investment	(92)	(89)	(274)	(266)
Other income	(34)	(15)	(220)	(43)
Interest rate swap ineffectiveness	—	269	(29)	269
Gain on sales of non-operating real estate	(24)	—	(24)	—
Income from discontinued operations	—	(133)	—	(2,397)
Depreciation and amortization from continuing operations	16,948	15,335	48,891	46,510
Interest expense	8,845	8,426	26,183	26,844
General and administrative expense	2,589	2,453	8,730	8,105

Acquisition costs	16	45	183	64
PROPERTY NET OPERATING INCOME	$36,629	33,106	106,651	99,340

The Company believes FFO is a meaningful supplemental measure of operating performance for equity REITs. The Company believes excluding depreciation and amortization in the calculation of FFO is appropriate since real estate values have historically increased or decreased based on market conditions. FFO is not considered as an alternative to net income (determined in accordance with GAAP) as an indication of the Company's financial performance, nor is it a measure of the Company's liquidity or indicative of funds available to provide for the Company's cash needs, including its ability to make distributions. In addition, FFO, as reported by the Company, may not be comparable to FFO reported by other REITs that do not define the term in accordance with the current NAREIT definition. The Company's key drivers affecting FFO are changes in PNOI (as discussed above), interest rates, the amount of leverage the Company employs and general and administrative expense. The following table presents reconciliations of Net Income Attributable to EastGroup Properties, Inc. Common Stockholders to FFO Attributable to Common Stockholders for the three and nine months ended September 30, 2013 and 2012.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	(In thousands, except per share data)			
NET INCOME ATTRIBUTABLE TO EASTGROUP PROPERTIES, INC. COMMON STOCKHOLDERS	$8,363	6,771	23,160	20,146
Depreciation and amortization from continuing operations	16,948	15,335	48,891	46,510
Depreciation and amortization from discontinued operations	—	101	—	483
Depreciation from unconsolidated investment	33	33	100	100
Depreciation and amortization from noncontrolling interest	(58)	(65)	(186)	(191)
Gain on sales of real estate investments	—	—	—	(1,869)
FUNDS FROM OPERATIONS (FFO) ATTRIBUTABLE TO COMMON STOCKHOLDERS	$25,286	22,175	71,965	65,179
Net income attributable to common stockholders per diluted share	$0.28	0.23	0.77	0.71
Funds from operations (FFO) attributable to common stockholders per diluted share	$0.83	0.76	2.39	2.30
Diluted shares for earnings per share and funds from operations	30,400	29,030	30,124	28,361

The Company analyzes the following performance trends in evaluating the progress of the Company:

- The FFO change per share represents the increase or decrease in FFO per share from the current period compared to the same period in the prior year. FFO per share for the third quarter of 2013 was $.83 per share compared with $.76 per share for the same period of 2012, an increase of 9.2% per share. For the nine months ended September 30, 2013, FFO was $2.39 per share compared with $2.30 per share for the same period of 2012, an increase of 3.9% per share.

- For the three months ended September 30, 2013, PNOI increased by $3,523,000, or 10.6%, compared to the same period in 2012. PNOI increased $1,858,000 from 2012 and 2013 acquisitions, $969,000 from newly developed properties and $740,000 from same property operations.

For the nine months ended September 30, 2013, PNOI increased by $7,311,000, or 7.4%, compared to the same period in 2012. PNOI increased $4,115,000 from 2012 and 2013 acquisitions, $2,234,000 from newly developed properties and $1,080,000 from same property operations.

- The same property net operating income change represents the PNOI increase or decrease for the same operating properties owned during the entire current period and prior year reporting period. PNOI from same properties increased 2.2% for the three months ended September 30, 2013, and increased 1.1% for the nine months compared to the same periods in 2012.

- Same property average occupancy represents the average month-end percentage of leased square footage for which the lease term has commenced as compared to the total leasable square footage for the same operating properties owned during the entire current period and prior year reporting period. Same property average occupancy for the three months ended September 30, 2013, was 94.9% compared to 93.9% for the same period of 2012. Same property average occupancy for the nine months ended September 30, 2013, was 93.9% compared to 93.6% for the same period of 2012.

- The same property average rental rate represents the average annual rental rates of leases in place for the same operating properties owned during the entire current period and prior year reporting period. The same property average rental rate was $5.19 per square foot for the three months ended September 30, 2013, compared to $5.09 per square foot for the same period of 2012. The same property average rental rate was $5.19 for the nine months ended September 30, 2013, compared to $5.04 for the same period of 2012.

- Occupancy is the percentage of leased square footage for which the lease term has commenced as compared to the total leasable square footage as of the close of the reporting period. Occupancy at September 30, 2013, was 95.7%. Quarter-end occupancy ranged from 93.6% to 94.6% over the period from September 30, 2012 to June 30, 2013.

- Rental rate change represents the rental rate increase or decrease on new and renewal leases compared to the prior leases on the same space. Rental rate increases on new and renewal leases (5.7% of total square footage) averaged 2.1% for the third quarter of 2013. For the nine months ended September 30, 2013, rental rate increases on new and renewal leases (17.2% of total square footage) averaged 1.6%.

- Lease termination fee income for the three and nine months ended September 30, 2013 was $3,000 and $430,000, respectively, compared to $57,000 and $314,000,respectively, for the same periods of 2012. Bad debt expense for the three and nine months ended September 30, 2013 was $58,000 and $154,000, respectively, compared to $155,000 and $539,000, respectively, for the same periods last year.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The Company's management considers the following accounting policies and estimates to be critical to the reported operations of the Company.

Real Estate Properties
The Company allocates the purchase price of acquired properties to net tangible and identified intangible assets based on their respective fair values. Goodwill is recorded when the purchase price exceeds the fair value of the assets and liabilities acquired. Factors considered by management in allocating the cost of the properties acquired include an estimate of carrying costs during the expected lease-up periods considering current market conditions and costs to execute similar leases. The allocation to tangible assets (land, building and improvements) is based upon management's determination of the value of the property as if it were vacant using discounted cash flow models. The purchase price is also allocated among the following categories of intangible assets: the above or below market component of in-place leases, the value of in-place leases, and the value of customer relationships. The value allocable to the above or below market component of an acquired in-place lease is determined based upon the present value (using a discount rate reflecting the risks associated with the acquired leases) of the difference between (i) the contractual amounts to be paid pursuant to the lease over its remaining term and (ii) management's estimate of the amounts that would be paid using fair market rates over the remaining term of the lease. The amounts allocated to above and below market leases are included in Other Assets and Other Liabilities, respectively, on the Consolidated Balance Sheets and are amortized to rental income over the remaining terms of the respective leases. The total amount of intangible assets is further allocated to in-place lease values and customer relationship values based upon management's assessment of their respective values. These intangible assets are included in Other Assets on the Consolidated Balance Sheets and are amortized over the remaining term of the existing lease, or the anticipated life of the customer relationship, as applicable.

During the period in which a property is under development, costs associated with development (i.e., land, construction costs, interest expense, property taxes and other direct and indirect costs associated with development) are aggregated into the total capitalized costs of the property. Included in these costs are management's estimates for the portions of internal costs (primarily personnel costs) deemed directly or indirectly related to such development activities. The internal costs are allocated to specific development properties based on construction activity.

The Company reviews its real estate investments for impairment of value whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If any real estate investment is considered permanently impaired, a loss is recorded to reduce the carrying value of the property to its estimated fair value. Real estate assets to be sold are reported at the lower of the carrying amount or fair value less selling costs. The evaluation of real estate investments involves many subjective assumptions dependent upon future economic events that affect the ultimate value of the property. Currently, the Company's management knows of no impairment issues nor has it experienced any impairment issues in recent years. EastGroup currently has the intent and ability to hold its real estate investments and to hold its land inventory for future development. In the event of impairment, the property's basis would be reduced, and the impairment would be recognized as a current period charge on the Consolidated Statements of Income and Comprehensive Income.

Valuation of Receivables
The Company is subject to tenant defaults and bankruptcies that could affect the collection of outstanding receivables. In order to mitigate these risks, the Company performs credit reviews and analyses on prospective tenants before significant leases are executed and on existing tenants before properties are acquired. On a quarterly basis, the Company evaluates outstanding receivables and estimates the allowance for doubtful accounts. Management specifically analyzes aged receivables, customer credit-worthiness, historical bad debts and

current economic trends when evaluating the adequacy of the allowance for doubtful accounts. The Company believes its allowance for doubtful accounts is adequate for its outstanding receivables for the periods presented. In the event the allowance for doubtful accounts is insufficient for an account that is subsequently written off, additional bad debt expense would be recognized as a current period charge on the Consolidated Statements of Income and Comprehensive Income.

Tax Status

EastGroup, a Maryland corporation, has qualified as a real estate investment trust under Sections 856-860 of the Internal Revenue Code and intends to continue to qualify as such. To maintain its status as a REIT, the Company is required to distribute at least 90% of its ordinary taxable income to its stockholders. If the Company has a capital gain, it has the option of (i) deferring recognition of the capital gain through a tax-deferred exchange, (ii) declaring and paying a capital gain dividend on any recognized net capital gain resulting in no corporate level tax, or (iii) retaining and paying corporate income tax on its net long-term capital gain, with shareholders reporting their proportional share of the undistributed long-term capital gain and receiving a credit or refund of their share of the tax paid by the Company. The Company distributed all of its 2012 taxable income to its stockholders and expects to distribute all of its taxable income in 2013. Accordingly, no significant provision for income taxes was necessary in 2012, nor is any significant income tax provision expected to be necessary for 2013.

FINANCIAL CONDITION

EastGroup's assets were $1,465,647,000 at September 30, 2013, an increase of $111,545,000 from December 31, 2012. Liabilities increased $99,037,000 to $961,963,000, and equity increased $12,508,000 to $503,684,000 during the same period. The paragraphs that follow explain these changes in detail.

Assets

Real Estate Properties
Real Estate Properties increased $142,204,000 during the nine months ended September 30, 2013, primarily due to the purchase of the operating properties detailed below, capital improvements at the Company's properties and the transfer of twelve properties from Development, as detailed under Development below.

REAL ESTATE PROPERTIES ACQUIRED IN 2013	Location	Size	Date Acquired	Cost (1)
		(Square feet)		(In thousands)
Northfield Distribution Center	Dallas, TX	788,000	05/22/2013	$63,184
Interchange Park II	Charlotte, NC	49,000	07/01/2013	2,203
		837,000		$65,387

(1) Total cost of the properties acquired was $72,397,000, of which $65,387,000 was allocated to Real Estate Properties as indicated above. Intangibles associated with the purchase of real estate were allocated as follows: $8,399,000 to in-place lease intangibles, $158,000 to above market leases (both included in Other Assets on the Consolidated Balance Sheets) and $1,547,000 to below market leases (included in Other Liabilities on the Consolidated Balance Sheets). All of these costs are amortized over the remaining lives of the associated leases in place at the time of acquisition.

During the nine months ended September 30, 2013, the Company made capital improvements of $16,075,000 on existing and acquired properties (included in the Capital Expenditures table under Results of Operations). Also, the Company incurred costs of $3,708,000 on development properties subsequent to transfer to Real Estate Properties; the Company records these expenditures as development costs on the Consolidated Statements of Cash Flows.

Development
EastGroup's investment in development at September 30, 2013 consisted of properties in lease-up and under construction of $51,208,000 and prospective development (primarily land) of $96,281,000. The Company's total investment in development at September 30, 2013 was $147,489,000 compared to $148,255,000 at December 31, 2012. Total capital invested for development during the first nine months of 2013 was $61,561,000, which primarily consisted of costs of $45,144,000 and $11,420,000 as detailed in the development activity table below and costs of $3,708,000 on development properties subsequent to transfer to Real Estate Properties. The capitalized costs incurred on development properties subsequent to transfer to Real Estate Properties include capital improvements at the properties and do not include other capitalized costs associated with development (i.e., interest expense, property taxes and internal personnel costs).

The Company capitalized internal development costs of $1,028,000 and $2,873,000 for the three and nine months ended September 30, 2013, respectively, and $655,000 and $2,043,000 for the same periods of 2012. The increase in capitalized internal development costs in 2013 as compared to 2012 resulted from increased activity in the Company's development program in 2013.

During the first nine months of 2013, EastGroup purchased 50.9 acres of development land in Charlotte and San Antonio for $6,567,000. Costs associated with development land acquisitions are included in the development activity table. The Company transferred 12 development properties to Real Estate Properties during the first nine months of 2013 with a total investment of $57,330,000 as of the date of transfer.

DEVELOPMENT		Costs Incurred				
		Costs Transferred in 2013 [(1)]	For the Nine Months Ended 9/30/2013	Cumulative as of 9/30/2013	Estimated Total Costs	Building Completion Date
		(In thousands)				
LEASE-UP	Building Size (Square feet)					
Beltway Crossing XI, Houston, TX	87,000	$—	1,115	4,715	5,100	02/13
Thousand Oaks 3, San Antonio, TX	66,000	1,232	2,938	4,170	4,600	07/13
Ten West Crossing 2, Houston, TX	46,000	908	3,104	4,012	5,100	09/13
Ten West Crossing 3, Houston, TX	68,000	693	3,049	3,742	4,800	09/13
World Houston 37, Houston, TX	101,000	—	3,183	4,857	6,800	09/13
Total Lease-Up	368,000	2,833	13,389	21,496	26,400	
UNDER CONSTRUCTION						Anticipated Building Completion Date
Chandler Freeways, Phoenix, AZ	126,000	1,811	5,325	7,136	8,900	11/13
World Houston 38, Houston, TX	129,000	—	5,581	7,798	9,000	11/13
Steele Creek I, Charlotte, NC	71,000	895	1,227	2,122	5,300	01/14
Steele Creek II, Charlotte, NC	71,000	894	1,204	2,098	4,900	01/14
Horizon I, Orlando, FL	109,000	2,178	1,784	3,962		