

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

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

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**FORM 10-Q**

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

**For the quarterly period ended June 30, 2001**

or

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

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

**Commission File No. 1-12328**

**CHELSEA PROPERTY GROUP, INC.**

*(Exact name of registrant as specified in its charter)*

**Maryland**

*(State or other jurisdiction  
of incorporation or organization)*

**22-3251332**

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

**103 Eisenhower Parkway, Roseland, New Jersey 07068**

*(Address of principal executive offices - zip code)*

**(973) 228-6111**

*(Registrant's telephone number, including area code)*

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days Yes X No .

The number of shares outstanding of the registrant's common stock, \$0.01 par value was 16,736,003 at August 6, 2001.

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Chelsea Property Group, Inc.

## Index

**Part I. Financial Information**

Item 1. Financial Statements (Unaudited)	Page
Condensed Consolidated Balance Sheets as of June 30, 2001 and December 31, 2000	3
Condensed Consolidated Statements of Income for the three and six months ended June 30, 2001 and 2000	4
Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2001 and 2000	5
Notes to Condensed Consolidated Financial Statements	6
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	14
Item 3. Quantitative and Qualitative Disclosures about Market Risk	21

**Part II. Other Information**

Item 4. Submission of Matters to a Vote of Security Holders	22
Item 6. Exhibits and Reports on Form 8-K	22
Signatures	23

**Item 1. Financial Statements**

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

	June 30, 2001	December 31, 2000
Assets		
Rental properties:	(Unaudited)	
Land.....	\$ 118,613	\$ 118,238
Depreciable property.....	801,007	790,106
Total rental property.....	919,620	908,344
Accumulated depreciation.....	(196,253)	(175,692)
Rental properties, net.....	723,367	732,652
Cash and cash equivalents.....	42,349	18,036
Investments in affiliates.....	94,692	89,062
Notes receivable-related parties.....	490	2,216
Deferred costs, net.....	17,038	14,886

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Other assets.....	37,090	44,462
Total assets.....	\$ 915,026	\$ 901,314
Liabilities and stockholders' equity		
Liabilities:		
Unsecured bank debt.....	\$ 5,035	\$ 35,035
Unsecured Notes due 2001 - 2011.....	373,221	324,542
Mortgage debt.....	95,407	90,776
Construction payables.....	7,783	10,001
Accounts payable and accrued expenses.....	37,834	43,507
Obligation under capital lease.....	2,428	2,714
Accrued dividend and distribution payable.....	16,484	3,910
Other liabilities.....	12,606	18,267
Total liabilities.....	550,798	528,752
Commitments and contingencies		
Minority interest.....	97,435	101,203
Stockholders' equity:		
8.375% series A cumulative redeemable preferred stock, \$0.01 par value, authorized 1,000 shares, issued and outstanding 1,000 shares in 2001 and 2000 (aggregate liquidation preference \$50,000).....	10	10
Common stock, \$0.01 par value, authorized 50,000 shares, issued and outstanding 16,190 in 2001 and 15,957 in 2000.....	162	160
Paid-in-capital.....	351,591	348,141
Distributions in excess of net income.....	(84,095)	(76,829)
Accumulated other comprehensive loss.....	(875)	(123)
Total stockholders' equity.....	266,793	271,359
Total liabilities and stockholders' equity.....	\$ 915,026	\$ 901,314

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2001	2000	2001	2000
	----	----	----	----
Revenues:				
Base rent.....	\$28,651	\$26,607	\$57,402	\$52,858
Percentage rent.....	3,029	3,183	5,800	5,749
Expense reimbursements.....	11,797	10,231	22,421	19,005
Other income.....	2,820	2,085	5,498	4,033
Total revenues.....	46,297	42,106	91,121	81,645
Expenses:				
Operating and maintenance.....	12,608	11,485	24,726	21,340
Depreciation and amortization.....	11,746	10,329	23,305	21,207
General and administrative.....	1,125	982	2,208	1,740

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Other.....	681	626	1,463	1,164
Total expenses.....	26,160	23,422	51,702	45,451
Income before unconsolidated investments, interest expense and minority interest.....	20,137	18,684	39,419	36,194
Income from unconsolidated investments.....	3,285	389	6,556	444
Loss from Chelsea Interactive.....	(772)	(275)	(1,970)	(275)
Interest expense.....	(8,820)	(5,731)	(17,435)	(11,368)
Income before minority interest.....	13,830	13,067	26,570	24,995
Minority interest.....	(3,309)	(3,300)	(6,496)	(6,401)
Net income.....	10,521	9,767	20,074	18,594
Preferred dividend.....	(1,047)	(1,047)	(2,094)	(2,094)
Net income to common shareholders.....	\$9,474	\$8,720	\$17,980	\$16,500
Basic:				
Net income per common share.....	\$0.59	\$0.55	\$1.12	\$1.04
Weighted average common shares outstanding.....	16,180	15,936	16,119	15,935
Diluted:				
Net income per common share.....	\$0.57	\$0.54	\$1.09	\$1.03
Weighted average common shares and equivalents outstanding.....	16,688	16,166	16,571	16,089

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

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

	2001	2000
Cash flows from operating activities		
Net income.....	\$20,074	\$18,594
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization.....	23,305	21,207
Equity-in-earnings of unconsolidated investments in excess of distributions received.....	(939)	(444)
Loss from Chelsea Interactive.....	1,970	275
Minority interest in net income.....	6,496	6,401
Proceeds from non-compete receivable.....	4,600	4,600
Amortization of non-compete revenue.....	(2,568)	(2,568)
Additions to deferred lease costs.....	(417)	(213)
Other operating activities.....	(232)	74
Changes in assets and liabilities:		
Straight-line rent receivable.....	(647)	(699)
Other assets.....	5,192	8,033

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Accounts payable and accrued expenses.....	(1,585)	830
Net cash provided by operating activities.....	55,249	56,090
Cash flows used in investing activities		
Additions to rental properties.....	(13,937)	(30,309)
Additions to investments in affiliates.....	(15,818)	(13,154)
Additions to other assets.....	(5,000)	-
Distributions from investments in affiliates in excess of earnings.....	4,360	-
Additions to deferred development costs.....	(2,067)	(45)
Proceeds from sale of center.....	-	3,372
Payments from related parties.....	1,726	-
Net cash used in investing activities.....	(30,736)	(40,136)
Cash flows used in financing activities		
Distributions.....	(22,612)	(21,904)
Debt proceeds.....	157,664	82,458
Repayments of debt.....	(134,500)	(76,250)
Additions to deferred financing costs.....	(1,969)	(2,252)
Net proceeds from sale of common stock.....	1,217	92
Net cash used in financing activities.....	(200)	(17,856)
Net increase (decrease) in cash and cash equivalents.....	24,313	(1,902)
Cash and cash equivalents, beginning of period.....	18,036	8,862
Cash and cash equivalents, end of period.....	\$42,349	\$6,960

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

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

**1. Organization and Basis of Presentation**

Chelsea Property Group, Inc., formerly Chelsea GCA Realty, Inc., (the "Company") is a self-administered and self-managed real estate investment trust ("REIT"). The Company is the managing general partner of CPG Partners, LP, formerly Chelsea GCA Realty Partnership, LP, (the "Operating Partnership" or "OP"), an operating partnership that has interests in and provides development, leasing, marketing and management services for upscale and fashion-oriented manufacturers' outlet centers. As of June 30, 2001, the Company had interests in 27 properties in fifteen states and Japan (the "Properties") that contained approximately 8.2 million square feet of gross leasable area ("GLA"). The Company's existing portfolio includes properties in or near New York City, Los Angeles, Boston, Washington, D.C., San Francisco, Sacramento, Cleveland, Atlanta, Dallas, Portland (Oregon), Tokyo and Osaka, Japan, or at or near tourist destinations including Palm Springs, the Napa Valley, Orlando, and Honolulu. The Company also has a number of properties under development and expansion.

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

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

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

Company	83.7%	16,190,000	units
Unitholders	16.3%	3,155,000	units
		-----	-----
Total	100.0%	19,345,000	

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

The Company is principally engaged in the development, ownership, acquisition and operation of manufacturers' outlet centers and has one reportable segment, retail real estate. The Company evaluates real estate performance and allocates resources based on net operating income and weighted average sales per square foot. The primary sources of revenue are generated from tenant base rents, percentage rents and reimbursement revenue. Operating expenses primarily consist of common area maintenance, real estate taxes and promotional expenses. The retail real estate business segment meets the quantitative threshold for determining reportable segments.

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

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

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

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

As of January 1, 2001, the adoption of the new standard resulted in derivative instruments reported on the balance

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sheet as assets of \$33,000 and an adjustment of \$33,000 to accumulated other comprehensive loss and minority interest.

**3. Investments in Affiliates**

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

Non-controlling investments are accounted for under the equity method. Equity in earnings or losses of these affiliates and related management advisory, license and guarantee fees earned are included in income from unconsolidated investments and loss from Chelsea Interactive in the accompanying consolidated financial statements.

Following is a summary of investment in affiliates accounted for under the equity method as of June 30, 2001 (in thousands):

	F/C Acq.	Chelsea Japan	Simon	Chelsea Interact.	Value Retail	Other	Total
Balance 12/31/00	\$33,079	\$6,245	\$13,391	\$29,899	\$4,742	\$1,706	\$89,062
Additional investment	1,528	142	-	9,334	318	-	11,322
Income from uncons. invest. (1)	1,917	560	1,536	(1,970)	110	(81)	2,072
Distributions	(1,567)	-	(6,197)	-	-	-	(7,764)
Balance 6/30/01	\$34,957	\$6,947	\$8,730	\$37,263	\$5,170	\$1,625	\$94,692

(1) Excludes income from fees of \$995 from F/C Acquisition, \$996 from Chelsea Japan and \$523 from Simon.

During the three and six months ended June 30, 2001 and 2000, investments in affiliates contributed to the Company's income from unconsolidated investments as follows (in thousands):

	For the Three Months Ended June 30,					
	2001			2000		
	Inc. from Unconsol. Inv. Before Depr.	Depr.	Inc. from Unconsol. Inv.	Inc. from Unconsol. Inv. Before Depr.	Depr.	Inc. from Unconsol. Inv.
F/C Acquisition	\$2,088	\$660	\$1,428	\$ -	\$ -	\$ -
Chelsea Japan	1,304	366	938	-	-	-
Simon	1,512	566	946	334	-	334
Other	(27)	-	(27)	55	-	55
Total	\$4,877	\$1,592	\$3,285	\$389	\$ -	\$389
Chelsea Interactive	(\$299)	\$473	(\$772)	(\$192)	\$83	(\$275)

For the Six Months Ended June 30,  
2001 2000

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	Inc. from Unconsol. Inv. Before Depr.	Depr.	Inc. from Unconsol. Inv.	Inc. from Unconsol. Inv. Before Depr.	Depr.	Inc. from Unconsol. Inv.
F/C Acquisition	\$4,229	\$1,317	\$2,912	\$ -	\$ -	\$ -
Chelsea Japan	2,175	619	1,556	-	-	-
Simon	3,195	1,136	2,059	334	-	334
Other	29	-	29	110	-	110
<b>Total</b>	<b>\$9,628</b>	<b>\$3,072</b>	<b>\$6,556</b>	<b>\$ 444</b>	<b>\$ -</b>	<b>\$ 444</b>
Chelsea Interactive	(\$917)	\$1,053	(\$1,970)	(\$ 192)	\$ 83	(\$ 275)

#### 4. Non-Compete Agreement

The Company recognized income from its non-compete agreement with The Mills Corporation of \$2.6 million during the six months ended June 30, 2001 and 2000. Such amounts are included in other income.

#### 5. Debt

The Company has a \$160 million senior unsecured bank line of credit (the "Senior Credit Facility") that expires on March 30, 2003. The Company has an annual right to request a one-year extension of the Senior Credit Facility which may be granted at the option of the lenders. Lenders representing \$145 million extended the Facility until March 30, 2004. The Senior Credit Facility bears interest on the outstanding balance, payable monthly, at a rate equal to the London Interbank Offered Rate ("LIBOR") plus 1.05% (4.92% at June 30, 2001) or the prime rate, at the Company's option. The LIBOR rate spread ranges from 0.85% to 1.25% depending on the Company's Senior Debt rating. A fee on the unused portion of the Senior Credit Facility is payable quarterly at rates ranging from 0.15% to 0.25% depending on the balance outstanding. At June 30, 2001, the entire \$160 million was available under the Senior Credit Facility.

The Company also has a \$5 million term loan (the "Term Loan") which carries the same interest rate and maturity as the Senior Credit Facility. A summary of the terms of the Unsecured Notes outstanding as of June 30, 2001 and December 31, 2000 is as follows:

	June 30, 2001	December 31, 2000	Effective Yield (1)
7.75% Unsecured Notes due January 2001....	\$ -	\$99,987	7.85%
8.375% Unsecured Notes due August 2005....	49,888	49,877	8.44%
7.25% Unsecured Notes due October 2007....	124,793	124,776	7.29%
8.625% Unsecured Notes due August 2009....	49,917	49,902	8.66%
8.25% Unsecured Notes due February 2011....	148,623	-	8.40%
<b>Total</b>	<b>\$373,221</b>	<b>\$324,542</b>	

(1) Including discount on the notes

In April 2000, Chelsea Financing entered into a \$70 million mortgage loan secured by four of its properties that matures April 2010 and bears interest at a rate equal to LIBOR plus 1.50% (5.56% at June 30, 2001) or prime rate plus



1.00%. The mortgage requires quarterly principal amortization of \$0.3 million through April 2005 and \$0.5 million thereafter. At June 30, 2001, \$68.7 million was outstanding. In December 2000, Chelsea Financing entered into an interest rate swap agreement effective January 2, 2001 with a financial institution for a notional amount of \$69.3 million amortizing to \$64.1 million to hedge against unfavorable fluctuations in the LIBOR rates of its secured mortgage loan facility. The hedge effectively produces a fixed interest rate of 7.2625% on the notional amount until January 1, 2006. As of June 30, 2001, the Company recognized net interest expense of \$0.2 million on the hedge which is included in interest expense.

In February 2000, Chelsea Allen entered into a \$40.0 million construction loan facility used to fund phase one of Allen Premium Outlets. The loan matures February 2003, bears interest on the outstanding balance at a rate equal to LIBOR plus 1.375% (5.17% at June 30, 2001) and is secured by the center and guaranteed by the Company and the OP. At June 30, 2001, \$26.7 million was outstanding.

Interest and loan costs of approximately \$0.5 million and \$1.1 million were capitalized as development costs during the three months ended June 30, 2001 and 2000, respectively; and approximately \$1.1 million and \$2.2 million during the six months ended June 30, 2001 and 2000, respectively.

## 6. Financial Instruments: Derivatives and Hedging

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

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

To manage interest rate and foreign currency risk, the Company may employ options, forwards, interest rate swaps, caps and floors or a combination thereof depending on the underlying exposure. The Company undertakes a variety of borrowings including lines of credit, medium- and long-term financings. To reduce overall interest cost, the Company may use interest rate instruments, typically interest rate swaps, to convert some or all of its variable rate debt to fixed rate debt, or some or all of its fixed-rate debt to variable rate. Interest rate differentials that arise under these swap contracts are recognized in interest expense over the life of the contracts.

The Company employs interest rate and foreign currency forwards or purchased options to hedge qualifying anticipated transactions. Gains and losses are deferred and recognized in net income in the same period that the underlying hedged transaction affects net income, expires or is otherwise terminated or assigned. As of June 30, 2001, there was \$0.8 million in deferred losses included in other comprehensive loss and minority interest.

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

Hedge Type	At June 30, 2001			
	Notional Value	Rate	Maturity	Fair Value
1) Swap, Cash Flow	\$68.7 mil	5.7625%	1/1/06	(\$0.8 mil)

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

On June 30, 2001, the derivative instrument was reported at its fair value as other liabilities of \$0.8 million.

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

Interest rate swaps that are designated as cash flow hedges hedge the future cash outflows on debt. Interest rate swaps that convert variable payments to fixed payments, interest rate caps, floors, collars, and forwards are cash flow hedges. The unrealized gains/losses in the fair value of cash flow hedges are reported on the balance sheet with a corresponding adjustment to accumulated other comprehensive loss to the extent they are offsetting and otherwise qualify in the period for cash flow hedge accounting. Over time, the unrealized gains and losses held in accumulated other comprehensive loss will be reclassified to earnings. This reclassification occurs over the same time period in which the hedge items affect earnings. Within the next twelve months, the Company expects to reclassify to earnings approximately \$0.2 million of the current balance held in accumulated other comprehensive loss and minority interest.

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

## 7. Stockholders' Equity

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

	Preferred Stock At Par Value	Common Stock At Par Value	Paid-in- Capital	Distrib. in Excess of Net Income	Accum. Other Comp. Loss	Total Stockholders' Equity
	-----	-----	-----	-----	-----	-----
Balance December 31, 2000.....	\$10	\$160	\$348,141	(\$76,829)	(\$123)	\$271,359
Net income.....	-	-	-	20,074	-	20,074
Other comprehensive loss						
Foreign currency translation...	-	-	-	-	(52)	(52)
Interest rate swap.....	-	-	-	-	(700)	(700)
Total comprehensive income.....						19,322
Preferred dividend.....	-	-	-	(2,094)	-	(2,094)
Cash distributions declared						
(\$1.56 per common share)....	-	-	-	(25,246)	-	(25,246)
Exercise of stock options.....	-	-	1,181	-	-	1,181
Shares issued in exchange						
for units of the OP.....	-	2	2,233	-	-	2,235
Shares issued through Employee						
Stock						
Purchase Plan						
(net of costs).....	-	-	36	-	-	36
Balance June 30, 2001.....	\$10	\$162	\$351,591	(\$84,095)	(\$875)	\$266,793

## 8. Dividends

On June 7, 2001, the Board of Directors of the Company declared a \$0.78 per share dividend to shareholders of record on June 30, 2001. The dividend, totaling \$12.6 million, was paid on July 16, 2001. The OP simultaneously paid a \$0.78 per unit cash distribution, totaling \$2.5 million, to its minority unitholders.

## 9. Income Taxes

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

## 10. Net Income Per Common Share

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

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

(In thousands, except per share amounts)	Three Months Ended June 30,		Six Months Ended June 30,	
	2001	2000	2001	2000
-----				
Numerator				
Numerator for basic and diluted earnings per share - net income to common shareholders.....	\$9,474	\$8,720	\$17,980	\$16,500
Denominator				
Denominator for basic earnings per share - weighted average shares.....	16,180	15,936	16,119	15,935
Effect of dilutive securities:				
Stock options.....	508	230	452	154
Denominator for diluted earnings per share - adjusted weighted-average shares and assumed conversions.....	16,688	16,166	16,571	16,089
Per share amounts:				
Net income - basic.....	\$0.59	\$0.55	\$1.12	\$1.04
Net income - diluted.....	\$0.57	\$0.54	\$1.09	\$1.03

## 11. Commitments and Contingencies

The 50/50 Orlando Premium Outlets ("OPO") joint venture with Simon has a \$66 million construction loan that matures March 2002 and bears interest at LIBOR plus 1.30% (5.59% at June 30, 2001). The loan is 10% guaranteed by each of the Company and Simon and as of June 30, 2001, \$58.2 million was outstanding. Changes in debt service coverage ratio provide for a guarantee ranging from 10% to 25% per guarantor and a LIBOR interest rate spread ranging from 130 to 150 basis points.

In October 1999, an equity investee of the Company entered into a 4 billion yen (approximately US \$32.1 million) line of credit guaranteed by the Company and OP to fund its share of Chelsea Japan's construction costs. The line of credit bears interest at yen LIBOR plus 1.35% (1.475% at June 30, 2001) and matures April 2002. At June 30, 2001, 1.32 billion yen (approximately US \$10.6 million) was outstanding under the loan. In March 2000, Chelsea Japan entered into a 3.8 billion yen (approximately US \$30.5 million) loan with a bank to fund construction costs. As of June 30, 2001, the entire facility was outstanding and bears interest at 2.20%. The loan is secured by the two operating

properties and is 40% guaranteed by the Company.

The Company has agreed under a standby facility to provide up to \$22 million in limited debt service guarantees for loans provided to Value Retail PLC and affiliates, to construct outlet centers in Europe. The term of the standby facility is three years and guarantees shall not be outstanding for longer than five years after project completion. As of June 30, 2001, the Company had provided limited debt service guarantees of approximately \$14.3 million to Value Retail PLC.

Other assets includes \$4.5 million at June 30, 2000, and accrued expenses and other liabilities include \$14.4 million and \$14.6 million in 2001 and 2000, respectively, related to a deferred unit incentive program with certain key officers to be paid in 2002. Also included is \$2.8 million in 2001 and \$7.4 million in 2000 related to the present value of future payments to be received from The Mills Corporation under the Houston non-compete agreement.

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

## **12. Related Party Information**

In 2001 the Company received a \$1.2 million payoff for one of the loans outstanding to unitholders and a \$0.5 million pay down on the other unitholder loan. At June 30, 2001 and 2000, \$0.5 million and \$2.2 million was due from the unitholders, respectively.

## **13. Subsequent Events**

On July 16, 2001, the Company announced that it had entered into a definitive agreement to purchase a portfolio of retail centers from Konover Property Trust, Inc. ("Konover"), for a purchase price of approximately \$180 million and posted a \$5.0 million escrow deposit. Closing is expected to take place in the third quarter of 2001.

On July 30, 2001, the Company completed the sale of 545,000 shares of common stock to an institutional investor at a net price of \$46.00 per share, yielding proceeds of \$25 million that may be used to partially fund the acquisition of the Konover assets and for general corporate purposes.

## **Chelsea Property Group, Inc.**

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

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

#### **General Overview**

From July 1, 2000 to June 30, 2001, the Company grew by increasing rents at its operating centers, opening four new centers, expanding three centers and acquiring four centers. Increasing rents at comparable centers resulted in base rent growth of \$0.8 million. The opening of one wholly-owned new center and expansion of three wholly-owned centers increased base rent by \$1.6 million and \$2.1 million, respectively. Income from unconsolidated investments increased by \$6.1 million primarily as a result of opening three new centers developed by joint ventures during 2000 and by acquiring a 49% interest in four centers through a joint venture in December 2000.

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The Company operated gross leasable area ("GLA") at June 30, 2001 of 8.2 million square feet including wholly and partially-owned GLA compared to 5.6 million square feet at June 30, 2000 and had an interest in 27 manufacturers' outlet centers at June 30, 2001 compared to 20 at the end of the same quarter in the prior year.

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

	12 mos ended June 30, 2001	6 mos ended June 30, 2001	6 mos ended December 31, 2000
	-----	-----	-----
Changes in GLA (sf in 000's):			
New centers developed:			
Gotemba Premium Outlets (40% owned).....	220	-	220
Allen Premium Outlets.....	206	-	206
Rinku Premium Outlets (40% owned).....	180	-	180
Orlando Premium Outlets (50% owned).....	88	-	88
	-----	-----	-----
Total new centers.....	694	-	694
Centers expanded:			
Wrentham Premium Outlets.....	127	-	127
Leesburg Premium Outlets.....	104	-	104
Allen Premium Outlets.....	34	34	-
	-----	-----	-----
Total centers expanded.....	265	34	231
Centers acquired (49% owned):			
Gilroy Premium Outlets.....	577	-	577
Lighthouse Place.....	491	-	491
Waterloo Premium Outlets.....	392	-	392
Kittery Premium Outlets.....	131	-	131
	-----	-----	-----
Total centers acquired.....	1,591	-	1,591
Net GLA added during the period.....	2,550	34	2,516
GLA at end of period.....	8,193	8,193	5,643

**Results of Operations**

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

Income before minority interest increased \$0.7 million to \$13.8 million for the three months ended June 30, 2001 from \$13.1 million for the three months ended June 30, 2000. Increases in revenues, primarily the result of new center development, expansions, and higher rents on releasing and renewals, and net earnings from unconsolidated investments that commenced operations in the second, third and fourth quarters of 2000 were partially offset by the loss from Chelsea Interactive and increases in operating, maintenance, depreciation and amortization and interest expenses.

Base rentals increased \$2.1 million, or 7.7%, to \$28.7 million for the three months ended June 30, 2001 from \$26.6 million for the three months ended June 30, 2000 due to the fourth quarter 2000 opening of Allen Premium Outlets, expansions and higher average rents on new leases and renewals.

Percentage rents decreased \$0.2 million or 4.8% to \$3.0 million for the three months ended June 30, 2001, from \$3.1 million for the three months ended June 30, 2000. The decrease was primarily due to changes of some tenants from overage to base rent.

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Expense reimbursements, representing contractual recoveries from tenants of certain common area maintenance, operating, real estate tax, promotional and management expenses, increased \$1.6 million, or 15.3%, to \$11.8 million for the three months ended June 30, 2001 from \$10.2 million for the three months ended June 30, 2000, due to the recovery of operating and maintenance costs from increased GLA. The average recovery of reimbursable expenses was 93.6% in the second quarter of 2001, compared to 89.1% in the second quarter of 2000, due to the recovery of operating expenses in the second quarter of 2001 reserved against in 2000.

Other income increased \$ 0.7 million to \$2.8 million for the three months ended June 30, 2001, from \$2.1 million for the three months ended June 30, 2000. The increase is primarily the result of increased interest and ancillary income.

Operating and maintenance expenses increased \$1.1 million, or 9.8%, to \$12.6 million for the three months ended June 30, 2001 from \$11.5 million for the three months ended June 30, 2000. The increase was primarily due to costs related to expansions, the new center opening and higher insurance costs on the existing centers.

Depreciation and amortization expense increased \$1.4 million, or 13.7%, to \$11.7 million for the three months ended June 30, 2001 from \$10.3 million for the three months ended June 30, 2000. The increase was due to depreciation of expansions and the new center opening.

General and administrative expense increased \$0.1 million to \$1.1 million for the three months ended June 30, 2001 from \$1.0 million for the three months ended June 30, 2000 primarily due to increased salaries.

Other expenses increased \$0.1 million to \$0.7 million for the three months ended June 30, 2001 from \$0.6 million for the three months ended June 30, 2000 primarily due to increased bad debt expense.

Income from unconsolidated investments increased \$2.9 million to \$3.3 million for the three months ended June 30, 2001 from \$0.4 million for the three months ended June 30, 2000. This resulted from equity-in-earnings and fees earned from the Company's unconsolidated investments that commenced operations during the second half of 2000.

The loss from Chelsea Interactive increased \$0.5 million to \$0.8 million for the three months ended June 30, 2001 from \$0.3 million for the three months ended June 30, 2000 due to increased depreciation, selling, general, administrative and maintenance expenses.

Interest in excess of amounts capitalized increased \$3.1 million to \$8.8 million for the three months ended June 30, 2001 from \$5.7 million for the three months ended June 30, 2000 primarily due to higher debt balances and lower construction balances.

### *Comparison of the six months ended June 30, 2001 to the six months ended June 30, 2000.*

Income before minority interest increased \$1.6 million to \$26.6 million for the six months ended June 30, 2001 from \$25.0 million for the six months ended June 30, 2000. Increases in revenues, primarily the result of new center development, expansions, and higher rents on releasing and renewals, and net earnings from unconsolidated investments that commenced operations in the second, third and fourth quarters of 2000 were partially offset by the loss from Chelsea Interactive and increases in operating, maintenance, depreciation and amortization and interest expenses.

Base rentals increased \$4.5 million, or 8.6%, to \$57.4 million for the six months ended June 30, 2001 from \$52.9 million for the six months ended June 30, 2000 due to the fourth quarter 2000 opening of Allen Premium Outlets, expansions and higher average rents on new leases and renewals.

Percentage rents increased \$0.1 million or 1.0% to \$5.8 million for the six months ended June 30, 2001 from \$5.7 million for the six months ended June 30, 2000 primarily due to sales of new tenants at the Company's centers during

the first quarter of 2001.

Expense reimbursements, representing contractual recoveries from tenants of certain common area maintenance, operating, real estate tax, promotional and management expenses, increased \$3.4 million, or 18.0%, to \$22.4 million for the six months ended June 30, 2001 from \$19.0 million for the six months ended June 30, 2000, due to the recovery of operating and maintenance costs from increased GLA. The average recovery of reimbursable expenses was 90.7% for the six months ended June 30, 2001, compared to 89.1% for the six months ended June 30, 2000.

Other income increased \$1.5 million to \$5.5 million for the six months ended June 30, 2001, from \$4.0 million for the six months ended June 30, 2000. The increase is primarily the result of increased interest and ancillary income.

Operating and maintenance expenses increased \$3.4 million, or 15.9%, to \$24.7 million for the six months ended June 30, 2001 from \$21.3 million for the six months ended June 30, 2000. The increase was primarily due to costs related to expansions, the new center opening and higher insurance costs on the existing centers.

Depreciation and amortization expense increased \$2.1 million, or 9.9%, to \$23.3 million for the six months ended June 30, 2001 from \$21.2 million for the six months ended June 30, 2000. The increase was due to depreciation of expansions and the new center opening.

General and administrative expense increased \$0.5 million to \$2.2 million for the six months ended June 30, 2001 from \$1.7 million for the six months ended June 30, 2000 primarily due to increased salaries.

Other expenses increased \$0.3 million to \$1.5 million for the six months ended June 30, 2001 from \$1.2 million for the six months ended June 30, 2000. The increase was primarily due to increases in bad debt, offset by a 2000 write-off of deferred site expense.

Income from unconsolidated investments increased \$6.1 million to \$6.5 million for the six months ended June 30, 2001 from \$0.4 million for the six months ended June 30, 2000. This resulted from equity-in-earnings and fees earned from the Company's unconsolidated investments that commenced operations during the second half of 2000.

The loss from Chelsea Interactive increased \$1.7 million to \$2.0 million for the six months ended June 30, 2001 from \$0.3 million for the six months ended June 30, 2000 due to increased depreciation, administrative and maintenance expenses.

Interest in excess of amounts capitalized increased \$6.0 million to \$17.4 million for the six months ended June 30, 2001 from \$11.4 million for the six months ended June 30, 2000 primarily due to higher debt balances and lower construction balances.

### **Liquidity and Capital Resources**

The Company believes it has adequate financial resources to fund operating expenses, distributions, and planned development, construction and acquisition activities over the short-term, which is less than 12 months and the long-term, which is 12 months or more. Operating cash flow in 2000 of \$104.5 million is expected to increase with a full year of operations of the 2.9 million square feet of GLA added during 2000, scheduled openings of approximately 145,000 square feet in 2001, representing additional phases of Allen Premium Outlets and a planned acquisition. As of June 30, 2001, the Company has adequate funding sources to complete and open all of its current development projects, including those of its e-commerce affiliate, Chelsea Interactive, Inc., through the use of available cash of \$42.3 million; a yen-denominated line of credit totaling 4 billion yen (US \$32.1 million) for the Company's share of projects in Japan; and approximately \$160 million available under its Senior Credit Facility. The Company also completed a \$25 million equity offering in July 2001 and has the ability to access the public markets through its \$450 million debt shelf registration and its \$275 million equity shelf registration.

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

Common distributions declared and recorded during the six months ended June 30, 2001 were \$30.2 million, or \$1.56 per share or unit. The Company's dividend payout ratio as a percentage of net income before minority interest, depreciation and amortization (exclusive of amortization of deferred financing costs ("FFO")) was 64.1% for the six months ended June 30, 2001. The Senior Credit Facility limits aggregate dividends and distributions to the lesser of (i) 90% of FFO on an annual basis or (ii) 100% of FFO for any two consecutive quarters.

During the fifteen month period ended July 2001, the Company completed four new debt financing transactions totaling \$360 million, both secured and unsecured, and the sale of common stock totaling \$25 million. These transactions strengthened the Company's financial flexibility and liquidity by extending and sequencing debt maturities and significantly reducing floating interest rate exposure at favorable rates.

On July 16, 2001, the Company announced that it had entered into a definitive agreement to purchase a portfolio of retail centers from Konover for a purchase price of approximately \$180 million including the assumption of debt of approximately \$135 million. Proceeds from the equity offering and cash on hand are available to fund the balance of the purchase price. Closing is expected to take place in the third quarter of 2001. On July 16, 2001 the Company posted a \$5.0 million escrow deposit.

On July 30, 2001, the Company completed the sale of 545,000 shares of common stock to an institutional investor at a net price of \$46.00 per share, yielding proceeds of \$25 million that may be used to partially fund the acquisition of the Konover assets and for general corporate purposes.

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

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

The Company has minority interests ranging from 5% to 15% in several outlet centers and outlet development projects in Europe. Outlet centers, outside of London, England, Barcelona and Madrid, Spain, are currently open and operated by Value Retail PLC and its affiliates. Three new European projects and expansions of the two existing centers are in various stages of development and are expected to open within the next two years. The Company's total investment in Europe as of June 30, 2001 was \$5.2 million. The Company has also agreed under a standby facility to provide up to \$22 million in limited debt service guarantees for loans provided to Value Retail PLC and affiliates, to construct outlet centers in Europe. The term of the standby facility is three years and guarantees shall not be outstanding for longer than five years after project completion. As of June 30, 2001, the Company had provided limited debt service guarantees of \$14.3 million for three projects.



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

Net cash provided by operating activities decreased \$0.8 million for the six months ended June 30, 2001 compared to the corresponding 2000 period, primarily due to the reduction of trade accounts payable and increased accounts receivable. Net cash used in investing activities decreased \$9.4 million for the six months ended June 30, 2001 compared to the corresponding 2000 period, as a result of decreased construction activity, increased distributions from joint venture investments and receipt of payments on the notes receivable, offset by the equity requirements of Chelsea Interactive and proceeds from sale of a center in 2000. Net cash used in financing activities decreased by \$17.7 million for the six months ended June 30, 2001 primarily due to the debt offering proceeds in January 2001, offset by the maturity of the 7.75% unsecured notes due January 2001, and payment of the Senior Credit Facility balance.

### Funds from Operations

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2001	2000	2001	2000
Net income to common shareholders.....	\$9,474	\$8,720	\$17,980	\$16,500
Add (deduct):				
Depreciation and amortization - wholly owned.....	11,746	10,329	23,305	21,207
Depreciation and amortization - joint ventures	1,592	-	3,072	-
Amortization of deferred financing costs and depreciation of non-rental real estate assets..	(438)	(429)	(846)	(937)
Preferred units distribution.....	(1,462)	(1,462)	(2,924)	(2,924)
Minority interest.....	3,309	3,300	6,496	6,401
FFO.....	\$24,221	\$20,458	\$47,083	\$40,247
Average diluted shares/units outstanding.....	19,843	19,523	19,776	19,446
Dividends declared per share.....	\$0.78	\$0.75	\$1.56	\$1.50

## Economic Conditions

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

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

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

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

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

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

At June 30, 2001 a hypothetical 100 basis point adverse move (increase) in US Treasury and LIBOR rates applied to unhedged debt would adversely affect the Company's annual interest cost by approximately \$0.3 million annually.

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

	Expected Maturity Date						Total	Fair Value
	2001	2002	2003	2004	2005	Thereafter		
Fixed Rate Debt:	-	-	-	-	\$49,888	\$323,333	\$373,221	\$378,945
Average Interest Rate:	-	-	-	-	8.375%	7.92%	7.98%	-
Variable Rate Debt:	-	-	\$26,658	5,035	-	\$68,750	\$100,443	\$100,443
Average Interest Rate:	-	-	5.17%	4.92%	-	7.26%	6.34%	-

## Chelsea Property Group, Inc.

## Part II. Other Information

### Item 4. Submission of Matters to a Vote of Security Holders

The Company held an annual meeting of stockholders on June 7, 2001, at which the following matters were voted upon:

1. Election of one director
2. Approval of appointment of Ernst & Young LLP as independent auditors for the fiscal year ending December 31, 2001

The results of the meeting were as follows:

Directors	For	Against	Abstain	Broker Non-Votes
Brendan T. Byrne	14,681,765	264,392	0	0
Proposal 2	14,571,617	33,261	341,278	0

Messrs. David C. Bloom, William D. Bloom, Robert Frommer, Barry M. Ginsburg, Philip D. Kaltenbacher and Reuben Leibowitz continued as directors after the meeting.

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

The Company did not file any reports on Form 8-K during the three months ended June 30, 2001.

#### **Chelsea Property Group, Inc.**

#### **Signatures**

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

CHELSEA PROPERTY GROUP, INC.

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

Date: August 14, 2001