

KOGER EQUITY INC
Form 10-Q
November 13, 2001

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**SECURITIES and EXCHANGE COMMISSION
Washington, D.C. 20549**

FORM 10-Q

(Mark One)

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

For the quarterly period ended **September 30, 2001** or

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

For the transition period from _____ to _____

Commission File Number **1-9997**

KOGER EQUITY, INC.

(Exact name of registrant as specified in its charter)

FLORIDA

59-2898045

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

**433 PLAZA REAL, SUITE 335
BOCA RATON, FLORIDA**

33432

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: **(561) 395-9666**

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

| Class | Outstanding at October 31, 2001 |
|-------------------------------|---------------------------------|
| Common Stock, \$.01 par value | 26,811,299 shares |

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INDEPENDENT ACCOUNTANTS REPORT

To the Board of Directors and Shareholders of
Koger Equity, Inc.
Jacksonville, Florida

We have reviewed the accompanying condensed consolidated balance sheet of Koger Equity, Inc. and subsidiaries (the Company) as of September 30, 2001 and the related condensed consolidated statements of operations for the three and nine month periods ended September 30, 2001 and 2000, the condensed consolidated statement of changes in shareholders' equity for the nine month period ended September 30, 2001 and the condensed consolidated statements of cash flows for the nine month periods ended September 30, 2001 and 2000. These financial statements are the responsibility of the Company's management.

We conducted our review in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists principally of applying analytical procedures to financial data and of making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States of America, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to such condensed consolidated financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

As described in Note 8 to the condensed consolidated financial statements, the Company has entered into an agreement to sell 3.9 million of rentable square feet to AREIF Realty Trust, an affiliate of Apollo Real Estate Advisors, L.P., a significant shareholder.

We have previously audited, in accordance with auditing standards generally accepted in the United States of America, the consolidated balance sheet of the Company as of December 31, 2000, and the related consolidated statements of operations, changes in shareholders' equity, and cash flows for the year then ended (not presented herein); and in our report dated February 23, 2001, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2000 is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

DELOITTE & TOUCHE LLP
Certified Public Accountants

West Palm Beach, Florida
October 26, 2001

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KOGER EQUITY, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited See Independent Accountants Report)
(In thousands)

| | September 30, 2001 | December 31, 2000 |
|---|-----------------------------------|----------------------------------|
| ASSETS | | |
| Real Estate Investments: | | |
| Operating properties: | | |
| Land | | |
| \$140,448 \$138,214 | | |
| Buildings | | |
| 831,406 805,935 | | |
| Furniture and equipment | | |
| 3,228 2,631 | | |
| Accumulated depreciation | | |
| (180,983) (155,817) | | |
| Operating properties net | | |
| 794,099 790,963 | | |
| Properties under construction: | | |
| Land | | |
| 2,128 | | |
| Buildings | | |
| 12,023 | | |
| Undeveloped land held for investment | | |
| 13,899 13,899 | | |
| Undeveloped land held for sale, net of allowance | | |
| 76 76 | | |
| Cash and cash equivalents | | |
| 9,140 1,615 | | |
| Accounts receivable, net of allowance for uncollectible accounts of \$787 and \$584 | | |
| 12,338 13,232 | | |
| Investment in Koger Realty Services, Inc. | | |
| 2,533 | | |

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Cost in excess of fair value of net
assets acquired, net of accumulated
amortization of \$1,323 and \$1,195

1,232 1,360

Other assets

13,997 13,193

TOTAL ASSETS

\$844,781 \$851,022

**LIABILITIES AND
SHAREHOLDERS EQUITY**

Liabilities:

Mortgages and loans payable

\$337,879 \$343,287

Accounts payable

3,090 4,961

Accrued real estate taxes payable

9,491 4,175

Accrued liabilities other

8,969 10,562

Dividends payable

9,381 9,392

Advance rents and security deposits

6,489 7,014

Total Liabilities

375,299 379,391

Minority interest

23,132 23,138

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Shareholders equity:

| | | |
|-----------------------------------|----------|----------|
| Common stock | 296 | 296 |
| Capital in excess of par value | 469,010 | 468,277 |
| Notes receivable from stock sales | (5,066) | (6,250) |
| Retained earnings | 17,460 | 20,261 |
| Treasury stock, at cost | (35,350) | (34,091) |

| | | |
|---------------------------|---------|---------|
| Total Shareholders Equity | 446,350 | 448,493 |
|---------------------------|---------|---------|

| | | |
|--|-----------|-----------|
| TOTAL LIABILITIES AND SHAREHOLDERS EQUITY | \$844,781 | \$851,022 |
|--|-----------|-----------|

See Notes to Unaudited Condensed Consolidated Financial Statements.

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KOGER EQUITY, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited See Independent Accountants Report)
(In thousands, except per share data)

| | Three Month Period Ended September 30, | | Nine Month Period Ended September 30, | |
|---|---|----------|--|-----------|
| | 2001 | 2000 | 2001 | 2000 |
| REVENUES | | | | |
| Rental and other rental services | \$42,243 | \$40,750 | \$125,462 | \$124,287 |
| Management fees | 1,074 | 604 | 3,530 | 1,255 |
| Interest | 154 | 229 | 596 | 478 |
| Income from Koger Realty Services, Inc. | 191 | 81 | 352 | |
| <hr/> | | | | |
| <hr/> | | | | |
| <hr/> | | | | |
| <hr/> | | | | |
| Total revenues | 43,471 | 41,774 | 129,669 | 126,372 |
| <hr/> | | | | |
| <hr/> | | | | |
| <hr/> | | | | |

EXPENSES

| | | | | |
|--------------------------------|--------|--------|--------|--------|
| Property operations | 15,591 | 16,267 | 46,749 | 47,964 |
| Depreciation and amortization | 9,844 | 8,760 | 27,834 | 25,886 |
| Mortgage and loan interest | 6,316 | 6,882 | 19,379 | 20,559 |
| General and administrative | 2,276 | 2,001 | 6,148 | 16,088 |
| Direct cost of management fees | | | | |

798 309 2,658 607
Other
60 55 171 191

Total expenses
34,885 34,274 102,939 111,295

**INCOME BEFORE GAIN ON SALE OR
DISPOSITION OF ASSETS, INCOME TAXES
AND MINORITY INTEREST**

8,586 7,500 26,730 15,077
Gain on sale or disposition of assets
2,033 6,437

**INCOME BEFORE INCOME TAXES AND
MINORITY INTEREST**

8,586 9,533 26,730 21,514
Income taxes
257 (174) 449 (19)

INCOME BEFORE MINORITY INTEREST

8,329 9,707 26,281 21,533

Minority interest

323 361 937 992

NET INCOME

\$8,006 \$9,346 \$25,344 \$20,541

EARNINGS PER SHARE:

Basic

\$0.30 \$0.35 \$0.94 \$0.77

Diluted

\$0.30 \$0.35 \$0.94 \$0.76

WEIGHTED AVERAGE SHARES:

Basic

26,865 26,710 26,872 26,707

Diluted
26,912 26,920 26,888 26,991

See Notes to Unaudited Condensed Consolidated Financial Statements.

See Notes to Unaudited Condensed Consolidated Financial Statements.

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KOGER EQUITY, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited See Independent Accountants Report)
(In thousands)

| | Nine Month Period Ended September 30, | |
|--|--|-------------|
| | 2001 | 2000 |
| OPERATING ACTIVITIES | | |
| Net income | \$25,344 | \$20,541 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 27,834 | 25,886 |
| Income from Koger Realty Services, Inc. | (81) | (352) |
| Provision for uncollectible accounts | 1,108 | 622 |
| Minority interest | 937 | 992 |
| Gain on sale or disposition of assets | (6,437) | |
| Changes in assets and liabilities: | | |
| Increase (decrease) in accounts payable, accrued liabilities and other liabilities | 395 | (3,014) |
| Increase in receivables and other assets | (1,305) | (891) |
| | | |
| | | |
| Net cash provided by operating activities | 54,232 | 37,347 |
| | | |
| | | |

INVESTING ACTIVITIES

Property acquisitions
 (10)
 Building and land construction
 expenditures
 (2,025) (12,075)
 Tenant improvements to first
 generation space
 (3,734) (3,361)
 Tenant improvements to existing
 properties
 (4,979) (7,108)
 Building improvements
 (3,086) (2,834)
 Energy management
 improvements
 (197) (196)
 Deferred tenant costs
 (1,568) (2,495)
 Additions to furniture and
 equipment
 (147) (270)
 Dividends received from Koger
 Realty Services, Inc.
 355
 Cash acquired in purchase of
 assets from KRSI
 2,535
 Proceeds from sale of assets
 15 49,743

Net cash provided by (used in)
 investing activities
 (13,186) 21,749

FINANCING ACTIVITIES

Collection of notes receivable from
 stock sales
 174
 Proceeds from exercise of stock
 options
 634 7,454
 Proceeds from sales of common
 stock
 199 2,057
 Proceeds from mortgages and
 loans
 32,500 68,783
 Dividends paid
 (28,156) (28,043)

Distributions paid to minority
interest holders
(943) (901)
Treasury stock purchased
(20,428)
Principal payments on mortgages
and loans
(37,908) (83,906)
Financing costs
(21) (16)

Net cash used in financing
activities
(33,521) (55,000)

Net increase in cash and cash
equivalents
7,525 4,096
Cash and cash equivalents
beginning of period
1,615

Cash and cash equivalents end of
period
\$9,140 \$4,096

**SUPPLEMENTAL CASH
FLOW INFORMATION**

Cash paid during the period for
interest, net of amount capitalized
\$19,543 \$20,717

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Cash paid during the period for
income taxes
\$252 \$155

See Notes to Unaudited Condensed Consolidated Financial Statements.

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**KOGER EQUITY, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE THREE AND NINE MONTH PERIODS
ENDED SEPTEMBER 30, 2001 AND 2000
(Unaudited See Independent Accountants Report)**

1. BASIS OF PRESENTATION. The condensed consolidated financial statements include the accounts of Koger Equity, Inc., its wholly-owned subsidiaries and Koger Vanguard Partners, L.P. (the Company). All material intercompany transactions and accounts have been eliminated in consolidation. The financial statements have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission related to interim financial statements.

During January 2001, Koger Equity, Inc. organized KRSI Merger, Inc., a Florida corporation, as a wholly owned taxable subsidiary. Effective February 1, 2001, Koger Realty Services, Inc. (KRSI), a Delaware corporation, was merged into this new subsidiary (the Merger). Pursuant to the Merger, the common stock of KRSI was repurchased at the formula price set forth in KRSI's Articles of Incorporation. Subsequent to the Merger, the name of the new Florida subsidiary was changed to Koger Realty Services, Inc. This merger was accounted for using the purchase method of accounting resulting in a reduction in the cost basis of assets of approximately \$143,000. Prior to the Merger, the Company accounted for its investment in the preferred stock of KRSI using the equity method.

The financial statements should be read in conjunction with the consolidated financial statements and notes thereto for the year ended December 31, 2000, included in the Company's Form 10-K Annual Report for the year ended December 31, 2000. The accompanying balance sheet at December 31, 2000, has been derived from the audited financial statements at that date and is condensed.

All adjustments of a normal recurring nature which, in the opinion of management, are necessary to present a fair statement of the results for the interim periods have been made. Results of operations for the nine month period ended September 30, 2001, are not necessarily indicative of the results to be expected for the full year.

On July 20, 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) No. 141, Business Combinations, and SFAS No. 142, Goodwill and Other Intangible Assets. These Statements make significant changes to the accounting for business combinations, goodwill, and intangible assets. SFAS No. 141 eliminates the pooling-of-interests method of accounting for business combinations with limited exceptions for combinations initiated prior to July 1, 2001. In addition, it further clarifies the criteria for recognition of intangible assets separately from goodwill. This statement is effective for business combinations completed after June 30, 2001.

SFAS No. 142 discontinues the practice of amortizing goodwill and indefinite lived intangible assets and initiates an annual review for impairment. Impairment would be examined more frequently if certain indicators are encountered. Intangible assets with a determinable useful life will continue to be amortized over that period. The amortization provisions apply to goodwill and intangible assets acquired after September 30, 2001. SFAS No. 142 is effective for fiscal years beginning after December 15, 2001. Goodwill and intangible assets on the books at September 30, 2001 will be affected when the Company adopts the Statement effective January 1, 2002.

The Company is evaluating the impact of the adoption of these standards and has not yet determined the effect of adoption on its financial position and results of operations.

2. ORGANIZATION. Koger Equity, Inc. (KE), a Florida corporation, was incorporated in 1988 for the purpose of investing in the ownership of income producing properties, primarily commercial office buildings. KE is self-administered and self-managed. Koger-Vanguard Partners, L.P. (KVP) is a Delaware limited partnership, for which KE is the general partner. Koger Equity's common stock is listed on the New York Stock exchange under the ticker symbol KE.

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In addition to managing its own properties, the Company provides property management services to certain third parties. The Company currently provides asset management services to Crocker Realty Trust for office properties containing approximately 4,802,000 rentable square feet. Crocker Realty Trust is in the process of selling this portfolio.

3. FEDERAL INCOME TAXES. KE is operated in a manner so as to qualify, and has elected tax treatment, as a real estate investment trust under the Internal Revenue Code (a REIT). As a REIT, KE is required to distribute annually at least 90 percent of its taxable income to its shareholders. Since KE had no REIT taxable income during 2000 and does not expect to have REIT taxable income during 2001, no provision has been made for Federal income taxes. To the extent that KE pays dividends equal to 100 percent of taxable income, the earnings of KE are not taxed at the corporate level. KE has a net operating loss carryforward which totals approximately \$2,481,000, which may be used to reduce REIT taxable income. However, the use of net operating loss carryforwards are limited for alternative minimum tax purposes. KE has recorded a provision of \$150,000 for alternative minimum tax for the nine months ended September 30, 2001. Koger Realty Services, Inc. has recorded a provision of \$241,000 for Federal income tax for the nine months ended September 30, 2001.

4. STATEMENTS OF CASH FLOWS. Cash in excess of daily requirements is invested in short-term monetary securities. Such temporary cash investments have an original maturity date of less than three months and are deemed to be cash equivalents for purposes of the statements of cash flows. During the nine month period ended September 30, 2001, the Company received 86,779 shares of its common stock as settlement of \$1,364,000 of notes receivables from former employees (\$1,010,000 of which were Notes Receivable from Stock Sales). Pursuant to the Merger, the Company acquired the net assets of KRSI in exchange for its preferred stock in KRSI. The net assets of KRSI acquired consisted of (i) cash in the amount of \$2,535,000, (ii) other assets with a fair value of \$1,016,000 and (iii) liabilities assumed with a fair value of \$937,000. During the nine month period ended September 30, 2000, the Company contributed 15,557 shares of common stock to the Company's 401(k) Plan. These shares had a value of approximately \$262,000 based on the closing price of the Company's common stock on the American Stock Exchange on December 31, 1999.

5. EARNINGS PER COMMON SHARE. Basic earnings per common share has been computed based on the weighted average number of shares of common stock outstanding for each period. Diluted earnings per common share is similar to basic earnings per share except that the weighted average number of common shares outstanding is increased to include the number of additional common shares that would have been outstanding if the dilutive common shares (options) had been issued. The treasury stock method is used to calculate dilutive shares which reduces the gross number of dilutive shares by the number of shares purchasable from the proceeds of the options assumed to be exercised.

6. MORTGAGES AND LOANS PAYABLE. At September 30, 2001, the Company had \$337,879,000 of loans outstanding, which are collateralized by mortgages on certain operating properties. Annual maturities for mortgages and loans payable are as follows (in thousands):

| Year Ending December 31, | |
|--------------------------|-----------|
| 2001 | \$ 89,568 |
| 2002 | |
| 12,720 | |
| 2003 | |
| 5,235 | |
| 2004 | |
| 5,672 | |
| 2005 | |
| 6,148 | |
| Subsequent | |
| Years | |
| 218,536 | |
| <hr/> | |
| Total | |
| \$337,879 | |
| <hr/> | |

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The Company's secured revolving credit facility will mature in December 2001. At September 30, 2001, the outstanding balance of this credit facility was \$88 million. The Company plans to extend or replace this credit facility.

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7. **DIVIDENDS.** The Company paid the following dividends during the nine months ended September 30, 2001:

| <u>Payment Date</u> | <u>Record Date</u> | <u>Dividends Per Share</u> |
|---------------------|--------------------|----------------------------|
| February 1, 2001 | December 31, 2000 | \$0.35 |
| May 3, 2001 | March 31, 2001 | \$0.35 |
| August 2, 2001 | June 30, 2001 | \$0.35 |

During the quarter ended September 30, 2001, the Company's Board of Directors declared a quarterly dividend of \$0.35 per share payable on November 1, 2001, to shareholders of record on September 30, 2001. The Company currently expects that all dividends paid during 2001 will be treated as ordinary income to the recipient for income tax purposes.

8. **AGREEMENT TO SELL PROPERTIES.** On August 23, 2001, the Company entered into an agreement to sell select non-core assets to AREIF Realty Trust, Inc. (AREIF), an affiliate of Apollo Real Estate Advisors, LP. Included in the sale are ten properties comprising 75 suburban office buildings and one retail center located throughout San Antonio and Austin, Texas; Greensboro and Charlotte, North Carolina; Greenville, South Carolina; and Birmingham, Alabama. The portfolio, which contains more than 3.9 million rentable square feet, will be purchased by AREIF for consideration including \$208.3 million cash, the exchange of AREIF's 5.73 million common share interest in the Company and a membership interest in the AREIF subsidiary entity acquiring the assets. The membership interest will provide the Company with a 20 percent participation in the net cash flow from the disposed assets after AREIF has received a 15 percent internal rate of return on its equity investment. Currently, the Company expects this transaction to close during December 2001.

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

The following discussion should be read in conjunction with the condensed consolidated financial statements and related notes appearing elsewhere in this Form 10-Q, and the Management's Discussion and Analysis of Financial Condition and Results of Operations included in the Company's Annual Report on Form 10-K for the period ended December 31, 2000.

RESULTS OF OPERATIONS.

Rental and other rental services revenues totaled \$42,243,000 for the quarter ended September 30, 2001, compared to \$40,750,000 for the quarter ended September 30, 2000. This increase in rental revenues resulted primarily from (i) increases in the Company's average rental rate and (ii) increases in rental revenues (\$2,504,000) from nine buildings constructed by the Company. The effect of these increases was partially offset by the loss of rental revenues (\$503,000) caused by the sale of two office parks during 2000 and the decrease in the Company's average occupancy. At September 30, 2001, the Company's buildings were on average 88 percent leased with an average rental rate of \$18.68 per usable square foot (\$16.58 per rentable square foot). At September 30, 2000, the Company's buildings were on average 92 percent leased with an average rental rate of \$16.81 per usable square foot. Rental and other rental services revenues totaled \$125,462,000 for the nine month period ended September 30, 2001, compared to \$124,287,000 during the same period last year. This increase resulted primarily from (i) increases in the Company's average rental rate and (ii) increases in rental revenues (\$6,521,000) from the nine buildings constructed by the Company. The effect of these increases was partially offset by the loss of rental revenues (\$5,143,000) caused by the sale of office parks as described above and the decrease in the Company's average occupancy.

Management fee revenues totaled \$1,074,000 for the quarter ended September 30, 2001, compared to \$604,000 for the quarter ended September 30, 2000. This increase was due primarily to (i) the merger of KRSI into a wholly owned taxable subsidiary of the Company on February 1, 2001 and (ii) the fees earned from Crocker Realty Trust (\$138,000). Management fee revenues increased to \$3,530,000 during the nine month period ended September 30, 2001, compared to \$1,255,000 during the same period last year, due to (i) the merger previously described and (ii) the fees earned from Crocker Realty Trust (\$397,000).

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Income from Koger Realty Services, Inc. decreased by \$191,000 and \$271,000, respectively, during the three and nine month periods ended September 30, 2001, compared to the same periods last year, due to the Merger.

Property operations expense includes charges for utilities, real estate taxes, janitorial, maintenance, property insurance, provision for uncollectible rents and management costs. The amount of property operations expense and its percentage of total rental revenues for the applicable periods are as follows:

| Period | Amount | Percent of Total Rental Revenues |
|--------------------------------|---------------|---|
| September 30, 2001 Quarter | \$ 15,591,000 | 36.9% |
| September 30, 2000 Quarter | | |
| 16,267,000 39.9% | | |
| September 30, 2001 Nine Months | | |
| 46,749,000 37.3% | | |
| September 30, 2000 Nine Months | | |
| 47,964,000 38.6% | | |

Property operations expense decreased primarily due to the decline in property operations expense (\$319,000 and \$2,195,000, respectively, for the three and nine month periods ended September 30, 2001) caused by the sale of two office parks during 2000 and the reduction in costs to manage the Company's properties. The effect of these decreases was partially offset by (i) increased accruals to provision for uncollectible accounts and (ii) increases in property operations expense (\$218,000 and \$1,061,000, respectively, for the three and nine month periods ended September 30, 2001) for the nine buildings constructed by the Company.

Depreciation expense has been calculated on the straight-line method based upon the useful lives of the Company's depreciable assets, generally 3 to 40 years. Depreciation expense increased \$981,000 and \$1,703,000, respectively, for the three and nine month periods ended September 30, 2001, compared to the same periods last year, due to (i) the construction completed during 2000 and 2001 and (ii) tenant and building improvements incurred after September 30, 2000. Amortization expense increased \$103,000 and \$245,000 respectively, for the three and nine month periods ended September 30, 2001, compared to the same periods last year, due primarily to deferred tenant costs incurred after September 30, 2000.

Interest expense decreased by \$566,000 and \$1,180,000, respectively, during the three and nine month periods ended September 30, 2001, compared to the same periods last year, primarily due to decreases in the average balance of mortgages and loans payable and in the weighted average interest rate on the secured revolving credit facility. At September 30, 2001 and 2000, the weighted average interest rate on the Company's outstanding debt was approximately 7.19 percent and 8.04 percent, respectively.

General and administrative expenses for the three month periods ended September 30, 2001 and 2000, totaled \$2,276,000 and \$2,001,000, respectively. This increase is primarily due to an increase in legal and other professional fees. General and administrative expenses for the nine month periods ended September 30, 2001 and 2000, totaled \$6,148,000 and \$16,088,000, respectively. This decrease is primarily due to certain non-recurring charges incurred during 2000 for (i) costs of a corporate reorganization (\$6,832,000), (ii) severance payments made to certain former senior executives (\$2,562,000), (iii) changes in termination benefits under the supplemental executive retirement plan (\$584,000), (iv) payments to retiring directors (\$138,000) and (v) initial fees for listing on the New York Stock Exchange (\$161,000).

Direct costs of management contracts increased \$489,000 for the three month period ended September 30, 2001, compared to the same period last year, due primarily to the merger of KRSI into a wholly owned taxable subsidiary of the Company on February 1, 2001. Compared to the prior year, direct costs of management contracts increased \$2,051,000 for the nine months ended September 30, 2001. This increase was primarily due to the merger previously described.

Net income totaled \$8,006,000 for the quarter ended September 30, 2001, compared to \$9,346,000 for the corresponding period of 2000. This decrease is due primarily to (i) the decrease in gain on sale or disposition of assets and (ii) the increases

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in depreciation and amortization expense and income tax expense. These items were partially offset by (i) the increase in rental and other rental services revenues and (ii) the decreases in property operations expense and interest expense. Net income increased \$4,803,000 during the nine month period ended September 30, 2001, compared to the same period last year. This increase is due primarily to (i) the increase in rental and other rental services revenues and (ii) decreases in general and administrative expenses, property operations expense and interest expense. These items were partially offset by (i) the decrease in gain on sale or disposition of assets and (ii) the increases in depreciation and amortization expense and income tax expense.

LIQUIDITY AND CAPITAL RESOURCES.

Operating Activities During the nine months ended September 30, 2001, the Company generated approximately \$54.2 million in net cash from operating activities. The Company's primary internal sources of cash are (i) the collection of rents from buildings owned by the Company and (ii) the receipt of management fees paid to the Company in respect of properties managed on behalf of Koala Realty Holding Co., Inc. (Koala) and Crocker Realty Trust. As a REIT for Federal income tax purposes, the Company is required to pay out annually, as dividends, 90 percent of its taxable income (which, due to non-cash charges, including depreciation and net operating loss carryforwards, may be substantially less than cash flows). In the past, the Company has paid out dividends in amounts at least equal to its taxable income. The Company believes that its cash provided by operating activities will be sufficient to cover debt service payments and to pay the dividends required to maintain REIT status through 2001.

The level of cash flow generated by rents depends primarily on the occupancy rates of the Company's buildings and changes in rental rates on new and renewed leases and from escalation provisions in existing leases. At September 30, 2001, leases representing approximately 7.2 percent of the gross annualized rent from the Company's properties, without regard to the exercise of options to renew, were due to expire during the remainder of 2001. This represents 218 leases for space in buildings located in 19 of the 23 centers or locations in which the Company owns buildings. Certain of these tenants may not renew their leases or may reduce their demand for space. During the nine months ended September 30, 2001, leases were renewed on approximately 68 percent of the Company's rentable square feet, which were scheduled to expire during the nine month period. For those leases which were renewed, the average rental rate increased from \$14.97 to \$15.72, an increase of 5.0 percent. Based upon the number of leases which will expire during 2001 and 2002 and the competition for tenants in the markets in which the Company operates, the Company has and expects to continue to offer incentives to certain new and renewal tenants. These incentives may include the payment of tenant improvement costs and in certain markets reduced rents during initial lease periods.

The Company has benefited from existing economic conditions and stable vacancy levels for office buildings in many of the metropolitan areas in which the Company owns buildings. The Company believes that the southeastern and southwestern regions of the United States offer excellent growth potential due to their diverse regional economies, expanding metropolitan areas, skilled work force and moderate labor costs. However, the Company cannot predict whether such economic growth will continue and the Company is currently experiencing slower growth in the markets in which it owns buildings. Cash flow from operations could be reduced if economic growth were not to continue in the Company's markets and if this resulted in lower occupancy and rental rates for the Company's buildings.

Governmental tenants (including the State of Florida and the United States Government) which account for approximately 19.1 percent of the Company's leased space at September 30, 2001, may be subject to budget reductions in times of recession and governmental austerity measures. Consequently, there can be no assurance that governmental appropriations for rents may not be reduced. Additionally, certain of the Company's private sector tenants may reduce their need for office space in the future.

During May 2001, the agreement with Koala to manage 15 office buildings located in Tampa, Florida was terminated when the properties were sold by Koala. The Company earned fees of \$307,000 and incurred costs of \$224,000 for the management of

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these properties during the nine months ended September 30, 2001. Effective September 1, 2001, the agreement for Koger Realty Services, Inc. to manage the remaining 55 office buildings owned by Koala was terminated. The Company earned fees of \$2,784,000 and incurred costs of \$2,141,000 for the management of these properties during the nine months ended September 30, 2001. Koger Realty Services, Inc. currently has no agreements to manage third party owned properties.

Investing Activities At September 30, 2001, substantially all of the Company's invested assets were in real properties. Improvements to the Company's existing properties have been financed through internal operations. During the nine month period ended September 30, 2001, the Company's expenditures for improvements to existing properties decreased \$1,876,000 from the corresponding period of the prior year. This decrease was due to the reduction in expenditures for tenant improvements primarily caused by (i) the sale of two office parks during 2000 and (ii) the lower leasing activity of second generation space during the first nine months of 2001 compared to 2000.

Financing Activities The Company has a \$150 million secured revolving credit facility, with variable interest rates, (\$88 million of which was outstanding on September 30, 2001 at a weighted average interest rate of 4.78 percent) provided by First Union National Bank of Florida, AmSouth Bank, N.A., Citizens Bank of Rhode Island, Compass Bank and Guaranty Federal Bank.

Loan maturities and normal amortization of mortgages and loans payable are expected to total approximately \$101 million over the next 12 months. The Company's secured revolving credit facility will mature in December 2001. This credit facility will either be extended or replaced. The Company has filed shelf registration statements with respect to the possible issuance of up to \$300 million of its common and/or preferred stock and the Company has issued \$91.6 million of its common stock under such registration statements in prior years. At September 30, 2001, the Company had 20 office buildings, containing approximately 1.8 million rentable square feet, which were unencumbered.

The foregoing discussion contains forward-looking statements concerning 2001. The actual results of operations for 2001 could differ materially from those projected because of factors affecting the financial markets, reactions of the Company's existing and prospective investors, the ability of the Company to identify and execute development projects and acquisition opportunities, the ability of the Company to renew and enter into new leases on favorable terms, and other risk factors. See Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations Cautionary Statement Relevant to Forward-Looking Information for Purpose of the Safe Harbor Provisions of the Private Securities Litigation Reform Act of 1995 in the Company's Annual Report on Form 10-K for the Fiscal Year Ended December 31, 2000.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Interest Rate Risk. The Company currently has a \$150 million secured revolving credit facility with variable interest rates. The Company may incur additional variable rate debt in the future to meet its financing needs. Increases in interest rates on such debt could increase the Company's interest expense, which would adversely affect the Company's cash flow and the amount of distributions to its shareholders. The Company has not entered into any interest rate hedge contracts to mitigate this interest rate risk. As of September 30, 2001, the Company had \$88 million outstanding under the secured revolving credit facility. If the weighted average interest rate on this variable rate debt changes 100 basis points higher or lower, annual interest expense would be increased or decreased by approximately \$880,000.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

None.

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- (a) The following table sets forth, with respect to each Koger Center or location at September 30, 2001, gross square feet, rentable square feet, percentage leased, and the average annual rent per rentable square foot leased.

| Koger Center/Location | Gross Square Feet | Rentable Square Feet | Percent Leased(1) | Average Annual Rent Per Square Foot(2) |
|---------------------------------|-------------------------|----------------------------|----------------------|--|
| Atlanta Chamblee | 1,199,800 | 1,112,194 | 90% | \$ 18.07 |
| Atlanta Gwinnett (3) | 274,400 | 261,484 | 76% | 18.97 |
| Atlanta Perimeter | 184,000 | 176,503 | 93% | 20.74 |
| Austin (5) | 458,400 | 440,666 | 97% | 20.80 |
| Birmingham Colonnade (3)(5) | 471,200 | 451,994 | 89% | 16.59 |
| Birmingham Colonnade Retail (5) | 112,600 | 112,186 | 70% | 12.46(4) |
| Charlotte Carmel (5) | 339,200 | 322,842 | 91% | 17.71 |
| Charlotte University | 190,600 | 182,852 | 100% | 18.06 |
| Charlotte Vanguard | 548,200 | 525,615 | 89% | 15.99 |
| Greensboro South (5) | 749,200 | 692,463 | 72% | 14.44 |
| Greensboro Wendover (5) | 98,300 | 89,986 | 72% | 17.72 |
| Greenville Park Central (5) | 161,700 | 158,971 | 85% | 16.87 |
| Greenville Roper Mt. (5) | 431,000 | 402,656 | 83% | 15.89 |
| Jacksonville Baymeadows | 793,400 | 748,351 | 95% | 12.04(4) |
| Jacksonville JTB | 436,000 | 416,773 | 100% | 12.91(4) |
| Memphis Germantown (3) | 562,600 | 526,874 | 86% | 18.22 |
| Orlando Central | 699,700 | 614,902 | 97% | 15.61 |
| Orlando Lake Mary | 318,000 | 303,481 | 97% | 19.96 |
| Orlando University (3) | 405,200 | 380,289 | 90% | 17.96 |
| Richmond Paragon | 154,300 | 145,008 | 100% | 17.92 |
| San Antonio Airport (5) | 258,800 | 231,777 | 94% | 18.36 |
| San Antonio West (5) | 1,102,200 | 1,057,801 | 85% | 14.96 |
| St. Petersburg (3) | 715,500 | 666,726 | 86% | 15.79 |
| Tallahassee | 960,300 | 833,209 | 80% | 18.39 |

Total
11,624,600 10,855,603

Weighted Average Total Company
88% \$16.58

Weighted Average Operational Buildings
88% \$16.46

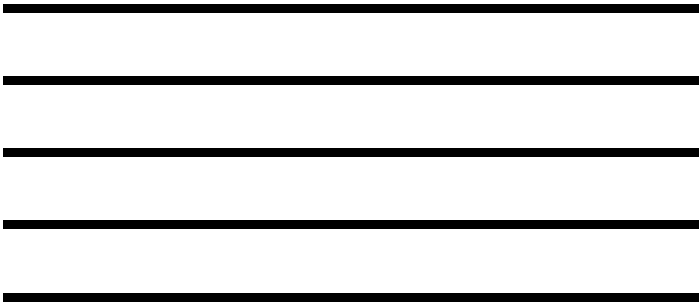
Weighted Average Buildings in Lease-up
81% \$19.68

-
- (1) The percent leased rates have been calculated by dividing total rentable square feet leased in an office building by rentable square feet in such building.
 - (2) Rental rates are computed by dividing (a) total annualized base rents (which excludes expense pass-through and reimbursements) for a Koger Center or location as of September 30, 2001 by (b) the rentable square feet applicable to such total annualized base rents.
 - (3) Includes a building which is currently in the lease-up period.
 - (4) Includes the effect of net leases where tenants pay certain operating costs in addition to base rent.
 - (5) The Company has entered into an agreement to sell these properties. See Footnote 8 on Page 10 for additional information.

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(b) The following schedule sets forth for all of the Company's buildings (i) the number of leases which will expire during the remainder of calendar year 2001 and calendar years 2002 through 2009, (ii) the total rentable area in square feet covered by such leases, (iii) the percentage of total rentable square feet represented by such leases, (iv) the average annual rent per square foot for such leases, (v) the current annualized base rents represented by such leases, and (vi) the percentage of total annualized base rents contributed by such leases. This information is based on the buildings owned by the Company on September 30, 2001 and on the terms of leases in effect as of September 30, 2001, on the basis of then existing base rentals, and without regard to the exercise of options to renew. Furthermore, the information below does not reflect that some leases have provisions for early termination for various reasons, including, in the case of government entities, lack of budget appropriations. Leases were renewed on approximately 68 percent of the Company's rentable square feet, which were scheduled to expire during the nine month period ended September 30, 2001.

| Period | Number of Leases Expiring | Number of Square Feet Expiring | Percentage | | Average Annual Rent per Square Foot Under Expiring Leases | Total Annualized Rents Under Expiring Leases | Percentage of Total Annualized Rents Represented by Expiring Leases |
|--------------|---------------------------|--------------------------------|----------------------|---------------------------|---|--|---|
| | | | of Total Square Feet | of Total Annualized Rents | | | |
| 2001 | 218 | 682,455 | 7.2% | | \$ 16.58 | \$ 11,314,865 | 7.2% |
| 2002 | 483 | 1,562,552 | 16.5% | 16.95 | 26,480,999 | 16.9% | |
| 2003 | 457 | 2,126,412 | 22.5% | 15.86 | 33,716,879 | 21.5% | |
| 2004 | 362 | 1,846,163 | 19.5% | 16.14 | 29,793,244 | 19.0% | |
| 2005 | 168 | 922,459 | 9.8% | 17.51 | 16,153,280 | 10.3% | |
| 2006 | 95 | 690,829 | 7.3% | 17.57 | 12,137,874 | 7.8% | |
| 2007 | 19 | 491,080 | 5.2% | 16.37 | 8,038,787 | 5.1% | |
| 2008 | 15 | 340,559 | 3.6% | 18.09 | 6,162,198 | 3.9% | |
| 2009 | 9 | 246,334 | 2.6% | 19.71 | 4,854,943 | 3.1% | |
| Other | 12 | 542,145 | 5.8% | 14.90 | 8,079,734 | 5.2% | |
| Total | 1,838 | 9,450,988 | 100.0% | \$16.58 | \$156,732,803 | 100.0% | |



(c) The Company believes that Funds from Operations is one measure of the performance of an equity real estate investment trust. Funds from Operations should not be considered as an alternative to net income as an indication of the Company's financial performance or to cash flow from operating activities (determined in accordance with generally accepted accounting principles) as a measure of the Company's liquidity, nor is it necessarily indicative of sufficient cash flow to fund all of the Company's needs. Funds from Operations is calculated as follows (in thousands):

| | Three Month Period Ended September 30, | | Nine Month Period Ended September 30, | |
|---|---|----------|--|----------|
| | 2001 | 2000 | 2001 | 2000 |
| Net Income | \$8,006 | \$9,346 | \$25,344 | \$20,541 |
| Depreciation - real estate | 8,849 | 7,889 | 24,991 | 23,348 |
| Amortization - deferred tenant costs | 597 | 500 | 1,658 | 1,431 |
| Amortization - goodwill | 43 | 43 | 128 | 128 |
| Minority interest | 323 | 361 | 937 | 992 |
| Gain on sale of operating properties | (1,709) | (6,385) | | |
| Gain on sale or disposition of non-operating assets | (324) | (52) | | |
| <hr/> | | | | |
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| <hr/> | | | | |
| Funds from Operations | \$17,818 | \$16,106 | \$53,058 | \$40,003 |

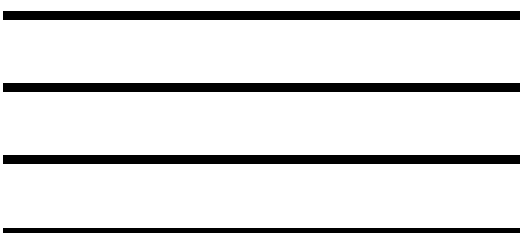


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Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

| <u>Exhibit Number</u> | <u>Description</u> |
|--|----------------------------------|
| 11 15 Letter re: Unaudited interim financial information. | Earnings Per Share Computations. |

(b) Report on Form 8-K

On August 27, 2001, the Company filed a Form 8-K (dated August 23, 2001) reporting under Item 9, Regulation FD Disclosure, the announcement of an agreement for the sale of certain of its non-core assets and providing under Item 7, Financial Statements and Exhibits, (i) Purchase and Sale Agreement by and among Koger Equity, Inc., as Seller, and AREIF II Realty Trust, Inc., as Buyer, dated as of August 23, 2001 and (ii) Koger Equity, Inc. News Release dated August 23, 2001.

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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.

KOGER EQUITY, INC.

Registrant

/s/ Robert E. Onisko

ROBERT E. ONISKO
CHIEF FINANCIAL OFFICER

Dated: November 12, 2001

/s/ James L. Stephens

JAMES L. STEPHENS
VICE PRESIDENT AND
CHIEF ACCOUNTING OFFICER