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BNP RESIDENTIAL PROPERTIES INC  
Form 10-Q  
November 06, 2006

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

FORM 10-Q

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

For the quarterly period ended September 30, 2006

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: 1-9496

BNP RESIDENTIAL PROPERTIES, INC.  
(Exact name of Registrant as specified in its charter)

Maryland  
State or other jurisdiction of organization

56-1574675  
(I.R.S. Employer incorporation or Identification No.)

301 S. College Street, Suite 3850, Charlotte, NC 28202-6024  
(Address of principal executive offices) (Zip Code)

704/944-0100  
(Registrant's telephone number)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer:  
Large accelerated filer \_ Accelerated filer X Non-accelerated filer \_

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of October 25, 2006 (the latest practicable date).

Common Stock, \$.01 par value	10,468,177
(Class)	(Number of shares)

Exhibit index: 35

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PART I - Financial Information

Item 1. Financial Statements.

BNP RESIDENTIAL PROPERTIES, INC.

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 Consolidated Balance Sheets  
 (all amounts in thousands except share amounts)

	September 30 2006	Decem 2
	----- (Unaudited)	
Assets		
Real estate investments at cost:		
Apartment properties	\$ 580,394	
Restaurant properties	37,405	
	-----	-----
	617,800	
Less accumulated depreciation	(100,692)	
	-----	-----
	517,108	
Cash and cash equivalents	2,533	
Prepaid expenses and other assets	11,392	
Deferred financing costs, net	2,438	
Intangible assets, net	1,126	
	-----	-----
Total assets	\$ 534,597	

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Liabilities and Shareholders' Equity	
Deed of trust and other notes payable	\$ 453,623
Accounts payable and accrued expenses	5,058
Accrued interest on notes payable	1,923
Consideration due for completed acquisitions	-
Deferred revenue and security deposits	2,405
	-----
Total liabilities	463,008
Minority interest in operating partnership	19,846
Shareholders' equity:	
Common stock, \$.01 par value, 100,000,000 shares authorized; 10,468,177 shares (205,000 nonvested) issued and outstanding at September 30, 2006; 10,385,890 shares (200,000 nonvested) issued and outstanding at December 31, 2005	103
Additional paid-in capital	123,644
Dividend distributions in excess of net income	(72,005)
	-----
Total shareholders' equity	51,742
	-----
Total liabilities and shareholders' equity	\$ 534,597
	=====

See accompanying notes

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BNP RESIDENTIAL PROPERTIES, INC.

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Consolidated Statements of Operations - Unaudited  
(all amounts in thousands except per share amounts)

	Three months ended September 30		Nine months e September
	2006	2005	2006
	-----		-----
Revenues			
Apartment rental income	\$ 20,313	\$ 17,701	\$ 59,011
Restaurant rental income	957	957	2,872
Interest and other income	48	234	285
	-----	-----	-----
	21,319	18,892	62,168
Expenses			
Apartment operations	7,965	7,079	22,788
Apartment administration	943	799	2,737
Corporate administration	730	683	2,557
Interest	6,732	6,034	19,675
Penalties paid at debt refinance	-	-	-
Depreciation	5,052	4,534	14,560
Amortization of deferred loan costs	132	112	398
Write-off of unamortized loan costs at debt refinance	-	-	-
Deficit distributions to minority partners	90	150	270

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Costs related to merger transaction	1,296	-	1,296
	-----	-----	-----
	22,941	19,392	64,282
	-----	-----	-----
	(1,622)	(500)	(2,113)
Loss attributed to minority interests			
- Consolidated limited partnerships	-	191	-
- Operating partnership	324	114	421
	-----	-----	-----
Loss from continuing operations	(1,298)	(195)	(1,692)
Discontinued operations:			
Income from discontinued operations	-	56	-
(Income) attributed to minority interests	-	(12)	-
	-----	-----	-----
Income from discontinued operations, net	-	45	-
	-----	-----	-----
Net loss	(1,298)	(150)	(1,692)
Less cumulative preferred dividend	-	(250)	-
	-----	-----	-----
Loss attributed to common shareholders	\$ (1,298)	\$ (400)	\$ (1,692)
	=====	=====	=====
Weighted average			
common shares outstanding	10,459	9,384	10,425
Earnings per common share - basic and diluted:			
Loss from			
- Continuing operations	\$ (0.13)	\$ (0.01)	\$ (0.17)
- Discontinued operations	-	-	-
Net loss	(0.13)	(0.01)	(0.17)
Loss attributed to common shareholders	(0.13)	(0.04)	(0.17)
Dividends declared per common share	\$ 0.26	\$ 0.25	\$ 0.78

See accompanying notes

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BNP RESIDENTIAL PROPERTIES, INC.

Consolidated Statement of Shareholders' Equity - Unaudited  
(all amounts in thousands)

	Common Stock Shares	Common Stock Amount	Additional paid-in capital	Dividend distributions in excess of net income
	-----	-----	-----	-----
Balance December 31, 2005	10,386	\$ 102	\$ 122,516	\$ (62,189)
Common stock issued	21	-	268	-
Service cost, nonvested common stock	-	-	86	-
Dividends paid - common	-	-	-	(2,701)
Net loss, first quarter	-	-	-	(214)
	-----	-----	-----	-----

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Balance March 31, 2006	10,407	102	122,869	(65,104)	
Common stock issued	22	-	360	-	
Service cost, nonvested common stock	-	-	86	-	
Dividends paid - common	-	-	-	(2,706)	
Net loss, second quarter	-	-	-	(180)	
-----					
Balance June 30, 2006	10,429	102	123,315	(67,990)	
Common stock issued	39	1	241	-	
Service cost, nonvested common stock	-	-	88	-	
Dividends paid - common	-	-	-	(2,717)	
Net loss, third quarter	-	-	-	(1,298)	
-----					
Balance September 30, 2006	10,468	\$ 103	\$ 123,644	\$ (72,005)	\$
=====					

See accompanying notes

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BNP RESIDENTIAL PROPERTIES, INC.

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 Consolidated Statements of Cash Flows - Unaudited  
 (all amounts in thousands)

	Nine months end September 30 2006
	-----
Operating activities:	
Apartment rental receipts, net	\$ 59,131
Restaurant rental receipts	2,872
Interest and other income receipts	172
Operating and administrative expense payments	(28,236)
Interest payments	(19,235)
Penalties paid at debt refinance	-
Payment of costs related to merger transaction	(1,296)
	-----
Net cash provided by operating activities	13,409
Investing activities:	
Acquisitions of apartment properties	(14,411)
Acquisition of Boddie Investment Company, net of cash included in accounts of consolidated limited partnerships	-
Additions to apartment properties, net	(7,922)
Net release (funding) of lender reserves	77
Casualty proceeds	1,141
	-----
Net cash used in investing activities	(21,115)
Financing activities:	
Net proceeds from issuance of common stock	918
Distributions to minority partners in consolidated limited partnerships	(270)
Distributions to operating partnership minority unitholders	(1,989)
Dividends paid to preferred shareholder	-

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Dividends paid to common shareholders	(8,123)
Proceeds from notes payable	26,925
Principal payments on notes payable	(9,877)
Deposits for pending financing transactions	-
Payment of deferred financing costs	(455)
Net cash provided by financing activities	7,128
Net (decrease) increase in cash and cash equivalents	(578)
Cash and cash equivalents at beginning of period	3,111
Cash and cash equivalents at end of period	\$ 2,533

(continued)

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BNP RESIDENTIAL PROPERTIES, INC.

Consolidated Statements of Cash Flows - Unaudited - continued  
(all amounts in thousands)

	Nine months end September 30 2006
Reconciliation of net loss to net cash provided by operating activities:	
Net loss	\$ (1,692)
Amortization of intangible for in-place leases at acquisitions	133
Casualty gains	(113)
Amortization of debt premium	(138)
Depreciation and amortization of deferred loan costs	14,958
Depreciation and amortization, discontinued operations	-
Write off of unamortized loan costs at debt refinancing	-
Deficit distributions to minority partners in consolidated limited partnerships	270
Minority interest in consolidated limited partnerships	-
Minority interest in operating partnership	(421)
Service cost related to nonvested common stock	260
Changes in operating assets and liabilities:	
Prepaid expenses and other assets	(3,836)
Accounts payable and accrued expenses	4,147
Deferred revenue, prepaid rent and security deposits	(158)
Net cash provided by operating activities	\$ 13,409

See accompanying notes

BNP RESIDENTIAL PROPERTIES, INC.

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Notes to Consolidated Financial Statements - September 30, 2006  
(Unaudited)

Note 1. Interim financial statements

We prepared the accompanying condensed consolidated financial statements in accordance with accounting principles generally accepted in the United States ("GAAP") for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. These interim financial statements do not include all information and notes required by GAAP for complete financial statements. However, except as disclosed herein, there has been no material change in the information disclosed in the notes to the consolidated financial statements included in the Annual Report on Form 10-K of BNP Residential Properties, Inc. for the year ended December 31, 2005. You should read these financial statements in conjunction with our 2005 Annual Report on Form 10-K. When we use the terms "we," "us," or "our," we mean BNP Residential Properties, Inc. and all entities included in our consolidated financial statements. We believe that we have included all adjustments (including normal recurring accruals) necessary for a fair presentation. Operating results for the three and nine months ended September 30, 2006, are not necessarily indicative of the results that may be expected for the year ending December 31, 2006.

We have reclassified certain amounts in our prior period consolidated financial statements and notes to conform to the current period presentation.

Note 2. Basis of presentation

These consolidated financial statements include the accounts of BNP Residential Properties, Inc. ("BNP," or the "company") and BNP Residential Properties Limited Partnership (the "operating partnership"). The company is the general partner and owns a majority interest in the operating partnership.

The consolidated financial statements also include the accounts of three real estate limited partnerships (the "limited partnerships") in which we have general partner interests. The assets of consolidated limited partnerships controlled by the operating partnership generally are not available to pay creditors of the company or the operating partnership.

Amounts for discontinued operations reflect the operating results for an apartment property that we sold in the fourth quarter of 2005.

We have eliminated all significant intercompany balances and transactions in the consolidated financial statements.

Accounting for stock-based compensation

The company has one employee Stock Option and Incentive Plan in place. Prior to July 1, 2005, we accounted for this plan using the intrinsic value method under the recognition and measurements principles of APB Opinion 25, "Accounting for Stock Issued to Employees," and related interpretations, as permitted by FASB Statement 123, "Accounting for Stock-Based Compensation." No stock-based employee compensation cost was reflected in net income, as all options granted under this plan had an exercise price equal to the market value of the underlying

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common stock on the date of grant. All outstanding options were fully vested prior to the end of 2004.

Effective July 1, 2005, we adopted the fair value recognition provisions of FASB Statement 123(R), "Share Based Payment," ("FAS 123(R)") using the modified-prospective transition method. Under this transition method, compensation cost includes compensation cost for all share-based payments granted subsequent to July 1, 2005, based on the grant-date fair value estimated in accordance with the provisions of FAS 123(R).

If we had applied the fair value recognition provisions of FAS 123 to options outstanding prior to July 1, 2005, there would have been no impact on net income as reported for the three or six months ended June 30, 2005, and no impact on basic and diluted earnings per share amounts as reported.

### Nonvested common stock

Effective August 1, 2005, the Board of Directors granted and issued 200,000 restricted shares of the company's common stock to four of our executive officers. All of the shares were unvested on the grant date, and vest 10% per year beginning July 1, 2006, and on each July 1 thereafter until fully vested. Once vested, the shares will be fully transferable without restriction. All shares carry dividend and voting rights. Because grantees fully participate in dividends, the fair value of the nonvested shares is equal to the market value at the grant date, \$15.70 per share, or a total of \$3,140,000. Because the grantee group is limited to four key executives, we estimate that 100% of these shares will vest. We recognize the cost of these awards on a straight-line basis for each annual vesting period ending June 30 through 2015.

During July and August 2006, the Board of Directors granted and issued 25,000 total additional restricted shares of the company's common stock to three additional employees. All of these shares were unvested on the grant dates, and vest 10% per year beginning July 2007. Once vested, these shares will be fully transferable without restriction. All shares carry dividend and voting rights. The fair value of these nonvested shares totals \$426,000, and we estimate that 100% of these shares will vest. We recognize the cost of these awards on a straight-line basis for each annual vesting period.

During the three and nine months ended September 30, 2006, we recorded service cost related to nonvested common stock totaling \$89,000 and \$260,000, respectively, included in apartment and corporate administration expenses in our statement of operations and as an increase to additional paid-in capital. As of September 30, 2006, unrecognized service cost related to nonvested common stock totaled \$3.2 million.

### Stock options

Options have been granted to employees at prices equal to the fair market value of the stock on the dates the options were granted or repriced. We calculated the fair value of each option grant on the date of grant using the Black-Scholes option-pricing model. Options are generally exercisable in four annual installments beginning one year after the date of grant, and expire ten years after the date of grant.

During the first quarter of 2006, two employees exercised stock options for a total of 7,000 shares of common stock. Changes in outstanding stock options during the nine months ended September 30, 2006, were as follows:

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Shares	Weighted Average Exercise Price
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Beginning balance	270,000	\$ 12.08
Exercised	(7,000)	10.11
	-----	-----
Ending balance	263,000	\$ 12.14
	=====	=====
Exercisable at September 30, 2006	263,000	\$ 12.14
	=====	=====

### Note 3. Agreement and plan of merger

On August 31, 2006, BNP and the operating partnership entered into an agreement and plan of merger pursuant to which an affiliate of international investment and advisory firm Babcock & Brown Limited ("Babcock & Brown") will acquire BNP through the mergers of BNP and the operating partnership with merger subsidiaries of Babcock & Brown. On October 17, 2006, the parties amended and restated the original merger agreement primarily to modify provisions relating to the merger of the operating partnership.

Pursuant to the terms of the merger agreement as amended, each issued and outstanding share of common stock of BNP will be converted into the right to receive \$24.00 in cash, without interest; common units in the operating partnership will remain common units in the surviving partnership unless the holder elects to receive cash or preferred units in the surviving partnership.

The merger agreement generally permits BNP to declare and pay regular quarterly cash distributions at a rate not to exceed \$0.26 per share of common stock during the pendency of the mergers. In addition, immediately prior to the mergers, the merger agreement permits BNP to set a record date for and declare payable a special distribution. The aggregate amount of the special distribution would equal, for the period from the last day of the last quarter for which BNP paid a full quarterly dividend to the record date for the special distribution, net income excluding gains (losses) from sales of property and certain transaction fees and expenses relating to the mergers, plus depreciation and amortization, and after adjustments of unconsolidated partnerships and joint ventures, all as calculated as provided in the merger agreement; provided that the special distribution may not exceed \$0.26 per share prorated for the number of days covered by the "stub" period.

The mergers and the transactions contemplated by the merger agreement have been approved by the board of directors of BNP on behalf of BNP, and on behalf of BNP as the sole general partner of the operating partnership. The mergers are subject to customary closing conditions, including the approval of the mergers by the holders of at least a majority of the outstanding common shares. The merger agreement contains no financing condition.

We intend to complete the mergers as soon as practicable following approval by our shareholders (for which we expect to schedule a special meeting in December 2006) and receipt of consents to the merger transactions, satisfactory to Babcock & Brown, from certain of our lenders. Accordingly, any delay in receiving such consents could result in a delay between the approval of the mergers and the effective date of the mergers until as late as June 30, 2007.

Upon termination of the merger agreement under certain specified circumstances, BNP may be required to pay the buyer a break-up fee of \$12.5 million.

Immediately prior to closing of the mergers, our executive officers will receive payments from BNP totaling \$8.4 million under their pre-existing employment agreements with BNP. In addition, all outstanding nonvested common stock held by

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employees of BNP will vest immediately before the merger and, as a result, all previously unrecognized service cost related to these shares will be recognized at that date.

In connection with the mergers, our executive officers have entered into revised definitive employment agreements, which become effective only if and when the mergers are effective, and which provide for each of their employment by the surviving company from the effective time of the mergers.

### Note 4. Acquisition and financing transactions

In April 2006, we acquired the Sterling Bluff Apartments, a 144-unit apartment property located in Carrboro, North Carolina, for a contract purchase price of \$9.4 million, from an unaffiliated third party. We funded this acquisition by a draw on our existing revolving line of credit. We operate the apartment community as Bridges at Chapel Hill Apartments.

In May 2006, we issued a \$7.3 million fixed-rate note payable, secured by a deed of trust and assignment of rents of Bridges at Chapel Hill Apartments. The loan provides for interest at 6.22% (6.3% effective rate), with interest only monthly payments of \$39,000 through June 2012. Beginning July 2012, scheduled monthly installments including principal and interest will be \$45,000, with a balloon payment of \$7.0 million in June 2016. In conjunction with this loan, we paid and recorded deferred loan costs of \$72,000. We applied proceeds of this loan to reduce our revolving line of credit.

In July 2006, we acquired the Quail Hollow Apartments, a 90-unit apartment property located in Charlotte, North Carolina, for a contract price of \$5.1 million, from an unaffiliated third party. We funded this acquisition by a draw on our existing revolving line of credit. We operate the apartment community as Bridges at Quail Hollow Apartments.

### Note 5. Shareholders' equity

During 2006, we have issued shares of our common stock as follows:

	Three months ended September 30	Nine months ended September 30
	-----	-----
Dividend Reinvestment and Stock Purchase Plan	14,423	
Exercise of options by employees	-	
Board of Directors compensation (1,000 shares to each of our non-management Board members)	-	
Grants of nonvested common stock	25,000	
	-----	-----
	39,423	
	=====	=====

We calculated basic and diluted earnings per common share using the following amounts (in thousands):

Three months ended

Nine months

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	September 30		September
	2006	2005	2006
	(000's)	(000's)	(000's)
<b>Numerators:</b>			
For per common share amounts -			
Net loss	\$ (1,298)	\$ (150)	\$ (1,692)
Cumulative preferred dividend	-	(250)	-
<hr/>			
Loss attributed to common shareholders - basic and diluted	\$ (1,298)	\$ (400)	\$ (1,692)
<hr/>			
<b>Denominators:</b>			
For per common share amounts -			
Weighted average common shares outstanding	10,459	9,384	10,425
Less weighted average nonvested common shares outstanding	(203)	(133)	(201)
<hr/>			
Weighted average common shares - basic	10,256	9,252	10,224
<b>Effect of potentially dilutive securities:</b>			
Convertible operating partnership units (1)	-	-	-
Nonvested common shares (2)	-	-	-
Stock options (3)	-	-	-
<hr/>			
For diluted earnings per share amounts - adjusted weighted average shares and assumed conversions	10,256	9,252	10,224
<hr/>			

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Note 6. Commitments

In June 2006, we entered into an exchange agreement with Laurel Springs III, LLC and its members, pursuant to which we will acquire the Laurel Springs Phase 3 Apartments, a 168-unit apartment property that is adjacent to our Laurel Springs community. The purchase price for the property will be \$11.7 million, consisting of the assumption or refinancing of approximately \$10.1 million of debt on the property and \$1.6 million to be paid in operating partnership units with an imputed value of \$16.70 per unit. Under the terms of the exchange agreement, we will complete the acquisition no later than January 2007, and we will issue half of the operating partnership units (approximately 47,000 units) in July 2007 and half in July 2008.

Note 7. Subsequent events

The Board of Directors declared a regular quarterly dividend of \$0.26 per common share on October 16, 2006, payable on November 15, 2006, to shareholders of record as of November 1, 2006.

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

This Quarterly Report contains forward-looking statements within the meaning of federal securities law. You can identify such statements by the use of forward-looking terminology, such as "may," "will," "expect," "anticipate," "estimate," "continue" or other similar words. These statements discuss future expectations, contain projections of results of operations or of financial condition or state other "forward-looking" information.

Although we believe that our plans, intentions and expectations reflected in or suggested by these forward-looking statements are reasonable, we cannot assure you that we will achieve our plans, intentions or expectations. When you consider such forward-looking statements, you should keep in mind the following important factors that could cause our actual results to differ materially from those contained in any forward-looking statement:

- o Our markets could suffer unexpected increases in the development of apartment, other rental or competitive housing alternatives;
- o our markets could suffer unexpected declines in economic growth or an increase in unemployment rates;
- o general economic conditions could cause the financial condition of a large number of our tenants to deteriorate;
- o we may not be able to lease or re-lease apartments quickly or on as favorable terms as under existing leases;
- o a decline in revenues from, or a sale of, our restaurant properties could adversely affect our financial condition and results of operations;
- o we may have incorrectly assessed the environmental condition of our properties;
- o an unexpected increase in interest rates could cause our debt service costs to exceed expectations;
- o we may not be able to meet our long-term liquidity requirements on favorable terms; and
- o we could lose the services of key executive officers.

Given these uncertainties, we caution you not to place undue reliance on forward-looking statements. We undertake no obligation to revise these forward-looking statements if future events or circumstances render them inaccurate.

You should read this discussion in conjunction with the financial statements and notes thereto included in this Quarterly Report and our Annual Report on Form 10-K, including the risk factors disclosed in our Annual Report.

### Company Profile

BNP Residential Properties, Inc. is a self-administered and self-managed real estate investment trust with operations in North Carolina, South Carolina and Virginia. Our primary activity is the ownership and operation of apartment communities. As of September 30, 2006, we owned and managed 32 apartment communities containing 8,180 units, and served as general partner of

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limited partnerships that owned three properties with 713 units, which we also managed. In addition to our apartment communities, we own 40 restaurant properties that we lease on a triple-net basis to a restaurant operator.

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We are structured as an UpREIT, or umbrella partnership real estate investment trust. The company is the sole general partner and owns a controlling interest in BNP Residential Properties Limited Partnership, through which we conduct all of our operations. We refer to this partnership as the operating partnership. We refer to the limited partners of the operating partnership as minority unitholders or as the minority interest in the operating partnership.

As of September 30, 2006, we had 10,468,177 shares of common stock outstanding. Our shares are listed on the American Stock Exchange and trade under the symbol "BNP." The operating partnership had an additional 2,608,693 operating partnership minority common units outstanding.

Our executive offices are located at 301 South College Street, Suite 3850, Charlotte, North Carolina 28202-6024, telephone 704/944-0100.

### Agreement and Plan of Merger

On August 31, 2006, BNP and the operating partnership entered into an agreement and plan of merger pursuant to which an affiliate of international investment and advisory firm Babcock & Brown Limited ("Babcock & Brown") will acquire BNP through the mergers of BNP and the operating partnership with merger subsidiaries of Babcock & Brown. On October 17, 2006, the parties amended and restated the original merger agreement primarily to modify provisions relating to the merger of the operating partnership.

Pursuant to the terms of the merger agreement as amended, each issued and outstanding share of common stock of BNP will be converted into the right to receive \$24.00 in cash, without interest; common units in the operating partnership will remain common units in the surviving partnership unless the holder elects to receive cash or preferred units in the surviving partnership.

The merger agreement generally permits BNP to declare and pay regular quarterly cash distributions at a rate not to exceed \$0.26 per share of common stock during the pendency of the mergers. In addition, immediately prior to the mergers, the merger agreement permits BNP to set a record date for and declare payable a special distribution. The aggregate amount of the special distribution would equal, for the period from the last day of the last quarter for which BNP paid a full quarterly dividend to the record date for the special distribution, net income excluding gains (losses) from sales of property and certain transaction fees and expenses relating to the mergers, plus depreciation and amortization, and after adjustments of unconsolidated partnerships and joint ventures, all as calculated as provided in the merger agreement; provided that the special distribution may not exceed \$0.26 per share prorated for the number of days covered by the "stub" period.

The mergers and the transactions contemplated by the merger agreement have been approved by the board of directors of BNP on behalf of BNP, and on behalf of BNP as the sole general partner of the operating partnership. The mergers are subject to customary closing conditions, including the approval of the mergers by the holders of at least a majority of the outstanding common shares. The merger agreement contains no financing condition.

We intend to complete the mergers as soon as practicable following approval by our shareholders (for which we expect to schedule a special meeting in December 2006) and receipt of consents to the merger transactions,

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satisfactory to Babcock & Brown, from certain of our lenders. Accordingly, any delay in receiving such consents could result in a delay between the approval of the mergers and the effective date of the mergers until as late as June 30, 2007.

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Upon termination of the merger agreement under certain specified circumstances, BNP may be required to pay the buyer a break-up fee of \$12.5 million.

Immediately prior to closing of the mergers, our executive officers will receive payments from BNP totaling \$8.4 million under their pre-existing employment agreements with BNP. In addition, all outstanding nonvested common stock held by employees of BNP will vest immediately before the merger and, as a result, all previously unrecognized service cost related to these shares will be recognized at that date.

In connection with the mergers, our executive officers have entered into revised definitive employment agreements, which become effective only if and when the mergers are effective, and which provide for each of their employment by the surviving company from the effective time of the mergers.

### Results of Operations

#### Summary

We were pleased with the results of the third quarter of 2006. The operating results reflect the growth in our apartment portfolio and continued improvement in our apartment operations and apartment markets. Demand for our apartments remained strong, and we saw increases in both occupancy and revenue per apartment unit. Meanwhile, apartment expenses have been consistent with our expectations.

We provide the following unaudited supplemental consolidating information, in response to requests from members of the investment community, for use in comparing our operating results for 2006 and 2005:

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	2006				P
	Consolidated	Elim	Consolidated LPs	Owned Properties	
	(000's)	(000's)	(000's)	(000's)	
<b>Operating Results - three months ended September 30:</b>					
<b>Revenues:</b>					
Apartment rental income	\$ 20,313	\$ -	\$ 2,022	\$ 18,292	\$
Restaurant rental income	957	-	-	957	
Management fee income	11	(101)	-	112	
Casualty gains	-	-	-	-	
Interest and other income	37	(44)	2	80	

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	21,319	(145)	2,024	19,441
Expenses:				
Apartment operations	7,965	(101)	921	7,145
Apartment administration	943	-	-	943
Corporate administration	730	-	-	730
Interest	6,732	(44)	681	6,096
Penalties paid at debt refinance	-	-	-	-
Depreciation	5,052	-	518	4,534
Amortization, loan costs	132	-	15	117
Write-off of unamortized loan costs at debt refinance	-	-	-	-
Deficit distributions to minority partners of consolidated limited partnerships(1)	90	-	90	-
Costs of merger transaction	1,296	-	-	1,296
	22,941	(145)	2,225	20,861
Loss from continuing operations	(1,622)	-	(201)	(1,420)
Income from discontinued operations	-	-	-	-
Loss before minority interests	(1,622)	\$ -	\$ (201)	\$ (1,420)
Minority interests -				
- Consolidated limited partnerships	-			
- Operating partnership	324			
Net loss	\$ (1,298)			
Loss before minority interests	\$ (1,622)	\$ -	\$ (201)	\$ (1,420)
Casualty gains	-	-	-	-
Cumulative preferred dividend	-	-	-	-
Amortization, lease intangible	23	-	-	23
Depreciation	5,052	-	518	4,534
Depreciation related to discontinued operations	-	-	-	-
Deficit distributions to minority partners of consolidated limited partnerships(1)	90	-	90	-
	3,543	-	406	3,136
Minority interest in FFO of consolidated limited partnerships	(130)	-	(130)	-
Funds from operations(2)	\$ 3,412	\$ -	\$ 276	\$ 3,136

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2006

Consolidated Owned

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	Consolidated	Elim	LPs	Properties	P
	(000's)	(000's)	(000's)	(000's)	
Operating Results - nine months ended September 30:					
Revenues:					
Apartment rental income	\$ 59,011	\$ -	\$ 5,995	\$ 53,016	
Restaurant rental income	2,872	-	-	2,872	
Management fee income	28	(301)	-	329	
Casualty gains	113	-	-	113	
Interest and other income	144	(129)	6	268	
	62,168	(431)	6,001	56,598	
Expenses:					
Apartment operations	22,788	(301)	2,569	20,520	
Apartment administration	2,737	-	-	2,737	
Corporate administration	2,557	-	-	2,557	
Interest	19,675	(129)	2,032	17,773	
Penalties paid at debt refinance	-	-	-	-	
Depreciation	14,560	-	1,306	13,254	
Amortization, loan costs	398	-	44	353	
Write-off of unamortized loan costs at debt refinance	-	-	-	-	
Deficit distributions to minority partners of consolidated limited partnerships(1)	270	-	270	-	
Costs of merger transaction	1,296	-	-	1,296	
	64,281	(431)	6,221	58,491	
Loss from continuing operations	(2113)	-	(220)	(1,893)	
Income from discontinued operations	-	-	-	-	
Loss before minority interests	(2113)	\$ -	\$ (220)	\$ (1,893)	
Minority interests -					
- Consolidated limited partnerships	-				
- Operating partnership	421				
Net loss	\$ (1,692)				
Loss before minority interests	\$ (2,113)	\$ -	\$ (220)	\$ (1,893)	
Casualty gains	(113)	-	-	(113)	
Cumulative preferred dividend	-	-	-	-	
Amortization, lease intangible	133	-	-	133	
Depreciation	14,560	-	1,306	13,254	
Depreciation related to discontinued operations	-	-	-	-	
Deficit distributions to minority partners of consolidated limited partnerships(1)	270	-	270	-	
	12,736	-	1,355	11,381	
Minority interest in FFO of consolidated limited partnerships	(565)	-	(565)	-	



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Funds from operations(2)	\$ 12,171	\$ -	\$ 790	\$ 11,381
	=====	=====	=====	=====

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	2006			
	Consolidated	Elim	Consolidated LPs	Owned Properties
	(000's)	(000's)	(000's)	(000's)
Balance Sheet at September 30, 2006, compared to December 31, 2005:				
Real estate investments	\$ 517,108	\$ -	\$ 41,479	\$ 475,629
Cash and cash equivalents	2,533	-	747	1,786
Prepaid expenses and other assets	11,392	4,352	974	6,066
Deferred financing costs, net	2,438	-	406	2,032
Intangible assets, net	1,126	-	-	1,126
	\$ 534,597	\$ 4,352	\$ 43,606	\$ 486,638
	=====	=====	=====	=====
Notes payable	\$ 453,623	\$ (2,612)	\$ 50,142	\$ 406,093
Accounts payable and accrued expenses	5,058	(58)	460	4,656
Accrued interest	1,923	-	204	1,719
Consideration due for acquisitions	-	-	-	-
Deferred revenue and security deposits	2,405	-	43	2,361
	463,008	(2,670)	50,849	414,829
Minority interests -				
- Consolidated limited partnerships	-	-	-	-
- Operating partnership	19,846	-	-	19,846
Shareholders' equity	51,742	7,022	(7,243)	51,962
	\$ 534,597	\$ 4,352	\$ 43,606	\$ 486,638
	=====	=====	=====	=====

Discontinued operations

We sold an apartment community in October 2005, and we present the results of operations of this apartment community as discontinued operations in our comparative statement of operations for 2005. Unless noted otherwise, the following discussion of operating results relates to our continuing operations.

Revenues

Total revenues in the third quarter of 2006 were \$21.3 million, compared to \$18.9 million in the third quarter of 2005. Total revenues in the first nine months of 2006 were \$62.2 million, compared to \$52.1 million in the

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first nine months of 2005. These increases are primarily attributable to increases in apartment rental income.

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Apartment rental income totaled \$20.3 million in the third quarter of 2006, an increase of \$2.6 million, or 14.8%, compared to the third quarter of 2005. Apartment rental income in the first nine months of 2006 totaled \$59.0 million, an increase of \$10.4 million, or 21.4%, compared to the first nine months of 2005. These increases are attributable to:

- o Apartment acquisitions - New communities contributed \$4.8 million in the third quarter and \$13.4 million in the first nine months of 2006, compared to \$3.1 million in the third quarter and \$5.7 million in the first nine months of 2005. During 2005 we acquired eight new properties, which we operate as seven apartment communities. We have acquired two new properties in 2006.
- o Apartment communities that we consolidated effective late January 2005 - These three partial-interest communities generated \$2.0 million in the third quarter and \$6.0 million in the first nine months of 2006, compared to \$1.9 million in the third quarter and \$5.2 million in February through September 2005.
- o Revenue increases at "same-units" communities - These communities generated \$13.5 million in the third quarter and \$39.6 million in the first nine months of 2006, compared to \$12.7 million in the third quarter and \$37.8 million in the first nine months of 2005.

On a "same-units" basis (the 23 apartment communities that we owned as of both January 1, 2005 and 2006), apartment rental income increased by 6.1% in the third quarter of 2006, and 4.9% in the first nine months of 2006, compared to the same periods in 2005. These increases are attributable to improvements in both occupancy and rental rates.

On a same-units basis, apartment NOI (apartment rental income less apartment operating expenses) for the third quarter of 2006 increased by 7.1% compared to the third quarter of 2005. Same-units apartment NOI for the first nine months of 2006 increased by 5.7% compared to the first nine months of 2005.

Summary amounts for our apartment communities' occupancy and revenue per occupied unit for the third quarter and first nine months of 2006 follow:

		Three months ended September 30, 2006		
	Number of apartment units	Average economic occupancy	Average monthly revenue per occupied unit	Average economic occupancy
Owned apartment communities:				
Same-units communities:				
Abbington Place	360	94.6%	\$821	93.5%
Allerton Place	228	96.3%	887	96.1%

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Barrington Place	348	96.0%	795	94.7%
Brookford Place	108	95.2%	719	96.1%
Carriage Club	268	97.1%	814	96.6%
Chason Ridge	252	95.1%	786	96.6%
Fairington	250	95.4%	796	95.0%
Latitudes	448	96.6%	1,028	95.4%
Madison Hall	128	93.0%	662	92.8%

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			Three months ended September 30, 2006	Nine months ended September 30, 2006
	Number of apartment units	Average economic occupancy	Average monthly revenue per occupied unit	Average economic occupancy
Mallard Creek 1	184	93.8%	688	93.5%
Mallard Creek 2	288	95.4%	862	94.9%
Marina Shores Waterfront	290	96.3%	923	95.0%
Oakbrook	162	95.8%	766	95.9%
Oak Hollow 1	222	97.0%	654	97.2%
Oak Hollow 2	240	94.1%	625	94.0%
Paces Commons	336	96.5%	692	95.5%
Paces Village	198	96.7%	731	95.3%
Pelham	144	94.7%	611	95.7%
Pepperstone	108	93.3%	721	94.3%
Savannah Place	172	96.1%	737	96.3%
Southpoint	192	93.2%	719	94.5%
Summerlyn Place	140	95.3%	895	95.3%
Waterford Place	240	96.9%	933	95.4%
Woods Edge	264	95.7%	699	95.4%
Wind River	346	96.6%	864	95.6%
Acquired in 2005:				
Canterbury	630	96.8%	691	97.0%
Hamptons	232	97.4%	783	96.2%
Laurel Springs 1	240	92.8%	632	92.1%
Laurel Springs 2	96	88.6%	792	85.9%
Paces Watch	232	97.7%	918	97.5%
Salem Ridge	120	92.9%	567	94.4%
Timbers	240	93.3%	879	92.2%
Waverly Place	240	95.6%	711	95.4%
Acquired in 2006:				
Chapel Hill	144	92.0%	765	90.9%
Quail Hollow	90	99.9%	726	99.9%
All apartments				
- 2006	8,180	95.6%	783	95.1%
- 2005	7,474	95.0%	744	94.9%

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Same units	5,916			
- 2006		95.7%	797	95.3%
- 2005		94.7%	759	94.8%
Consolidated limited partnerships:				
Marina Shores	392	97.4%	1,250	95.9%
Villages of Chapel Hill	264	87.2%	661	94.0%
Villages - Phase 5	57	92.5%	774	96.3%

Restaurant rental income was \$957,000 in the third quarters of both 2006 and 2005, and \$2.9 million in the first nine months of both 2006 and 2005. We received the minimum rent specified in the lease agreement in all periods. We currently hold 40 restaurant properties under this lease, and minimum rent is currently set at \$319,000 per month, or \$3.8 million per year.

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### Expenses

Total expenses were \$22.9 million in the third quarter of 2006, compared to \$19.4 million in the third quarter of 2005. Total expenses were \$64.3 million in the first nine months of 2006, compared to \$60.6 million in the first nine months of 2005. In addition to significant increases in both operating and financing expenses attributable to growth in the size our apartment operations, the 2006 amounts include \$1.3 million in costs related to the pending merger transaction. However, 2005 amounts include charges recorded by a consolidated limited partnership related to loan refinance transactions as well as one-time distributions to a minority partner from refinance proceeds.

Apartment operations expense (the direct costs of on-site operations at owned and consolidated apartment communities) totaled \$8.0 million in the third quarter of 2006, an increase of \$0.9 million, or 12.5%, compared to the third quarter of 2005. Apartment operations expense in the first nine months of 2006 totaled \$22.8 million, an increase of \$3.8 million, or 19.7%, compared to the first nine months of 2005. These increases are primarily attributable to:

- o Apartment acquisitions - Costs at new communities totaled \$2.0 million in the third quarter and \$5.3 million in the first nine months of 2006, compared to \$1.2 million in the third quarter and \$2.2 million in the first nine months of 2005.
- o Apartment communities that we consolidated effective late January 2005 - Costs at these three partial-interest communities totaled \$0.8 million in the third quarter and \$2.3 million in the first nine months of 2006, compared to \$0.8 million in the third quarter and \$2.0 million in February through September 2005.
- o Apartment operations expense increases at "same-units" communities - Costs at these 23 apartment communities totaled \$5.2 million in the third quarter and \$15.4 million in the first nine months, compared to \$5.0 million in the third quarter and \$14.8 million in the first nine months of 2005.

On a same-units basis, apartment operations expense increased by 4.5% in the third quarter of 2006, and 3.8% in the first nine months of 2006, compared to the same periods in 2005, due to expected increases in various operating costs.

Operating expenses for restaurant properties are insignificant because

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the triple-net lease arrangement requires the lessee to pay virtually all of the expenses associated with the restaurant properties.

Apartment administration expense (the costs associated with oversight, accounting, and support of our apartment management activities) totaled \$0.9 million in the third quarter of 2006, an 18.1% increase compared to the third quarter of 2005. Apartment administration expense in the first nine months of 2006 totaled \$2.7 million, a 23.8% increase compared to the first nine months of 2005. These increases are primarily attributable to additional corporate support and operations staff and computer system expenses.

Corporate administration expense totaled \$0.7 million in the third quarter of 2006, a 6.9% increase compared to the third quarter of 2005. Corporate administration expense in the first nine months of 2006 totaled \$2.6 million, a 16.0% increase compared to the first nine months of 2005. This increase is primarily attributable to executive compensation costs, including \$250,000 in

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charges during the first nine months of 2006 for service cost related to nonvested common stock issued in August 2005, compared to \$57,000 in such charges for the period August through September 2005.

Interest expense totaled \$6.7 million in the third quarter of 2006, an increase of \$0.7 million, or 11.6%, compared to the third quarter of 2005. Interest expense in the first nine months of 2006 totaled \$19.7 million, an increase of \$3.5 million, or 21.4%, compared to the first nine months of 2005. These increases are primarily attributable to new debt issued in conjunction with apartment acquisitions, along with the impact of consolidating three limited partnerships for nine full months in 2006 (compared to eight months in 2005). Overall, weighted average interest rates were 6.0% for the third quarters of both 2006 and 2005, and 5.9% for the first nine months of both 2006 and 2005.

Depreciation expense totaled \$5.1 million in the third quarter of 2006, an increase of \$0.5 million, or 11.4%, compared to the third quarter of 2005. Depreciation expense in the first nine months of 2006 totaled \$14.6 million, an increase of \$2.5 million, or 20.5%, compared to the first nine months of 2005. These increases are primarily attributable to apartment acquisitions in 2005 and 2006.

We reflect the unaffiliated partners' interests in Marina Shores Associates One, Limited Partnership ("Marina Shores Partnership"), The Villages of Chapel Hill Limited Partnership ("Villages Partnership"), and The Villages of Chapel Hill - Phase 5 Limited Partnership ("Villages Phase 5 Partnership") as minority interest in consolidated limited partnerships. Minority interest in consolidated limited partnerships represents the minority partners' share of the underlying net assets of these consolidated limited partnerships. When these consolidated limited partnerships make cash distributions to partners in excess of the carrying amount of the minority interest, we record a charge equal to the amount of such excess distributions, even though there is no economic effect or cost to the operating partnership. We report this charge in our consolidated statements of operations as deficit distributions to minority partners. We recorded charges for deficit distributions to the minority partner in the Marina Shores Partnership totaling \$90,000 in the third quarter of 2006, compared to \$150,000 in the third quarter of 2005. We recorded such charges for deficit distributions in the first nine months of 2006 totaling \$270,000, compared to \$7.8 million in the first nine months of 2005. We currently expect that the Marina Shores Partnership will continue to make regular distributions of approximately \$360,000 per year each to the limited partner and our operating

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partnership.

### Net Income

Consolidated earnings from continuing operations before non-cash charges (for depreciation, amortization and write-off of unamortized loan costs at refinance), before the charge for deficit distributions to a minority partner, and before the \$1.3 million charge for costs related to the pending merger transaction, totaled \$4.9 million in the third quarter of 2006, an increase of \$0.7 million, or 15.1%, compared to the third quarter of 2005. Consolidated earnings from continuing operations before non-cash charges, charges for deficit distributions to a minority partner and charges for costs related to the merger transaction totaled \$14.4 million in the first nine months of 2006, an increase of \$2.5 million, or 20.9%, compared to the first nine months of 2005. These increases reflect the impact of new apartment communities and improvements in apartment revenues. In addition, the comparable amounts for 2005 include a first quarter charge of \$0.5 million for penalties paid in conjunction with a refinance transaction for one of the consolidated limited partnerships.

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The net loss from continuing operations, before allocation to minority interests, was \$1.6 million in the third quarter of 2006 and \$2.1 million in the first nine months of 2006, compared to net loss from continuing operations of \$0.5 million in the third quarter of 2005 and \$8.5 million in the first nine months of 2005.

Under most circumstances, we would measure and allocate proportional income and losses of the consolidated limited partnerships to minority partners. However, because those partners' capital accounts have previously been reduced to \$-0- as a result of loss allocations or distributions in 2005, during 2006 we have absorbed 100% of the income and losses of those consolidated limited partnerships.

After allocating a portion of losses from continuing operations to minority interests in the operating partnership, the net loss from continuing operations was \$1.3 million in the third quarter and \$1.7 million in the first nine months of 2006, compared to \$0.2 million in the third quarter and \$6.6 million in the first nine months of 2005.

Amounts for discontinued operations reflect the operating results of Savannah Shores Apartments, which we sold in October 2005. Income from discontinued operations, net of the operating partnership minority interest, totaled \$45,000 in the third quarter and \$97,000 in the first nine months of 2005.

In November 2005, we redeemed all of the outstanding shares of preferred stock in exchange for shares of our common stock. Because the preferred shareholder had priority over common shareholders for receipt of dividends prior to this conversion, we deducted the amount of net income to be paid to the preferred shareholder, \$250,000 for the third quarter and \$750,000 for the first nine months, in calculating net income available to common shareholders for 2005.

The net loss attributed to common shareholders was \$1.3 million in the third quarter and \$1.7 million in the first nine months of 2006. Comparable amounts for 2005 were \$0.4 million in the third quarter and \$7.3 million in the first nine months.

### Funds from Operations

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Funds from operations is frequently referred to as "FFO." FFO is defined by the National Association of Real Estate Investment Trusts ("NAREIT") as "net income (computed in accordance with generally accepted accounting principles), excluding gains (losses) from sales of property, plus depreciation and amortization, and after adjustments for unconsolidated partnerships and joint ventures." Our calculation of FFO is consistent with FFO as defined by NAREIT. Because we hold all of our assets in and conduct all of our operations through the operating partnership, we measure FFO at the operating partnership level (i.e., after deducting the minority interests in FFO of the consolidated limited partnerships, but before deducting the minority interest in the operating partnership).

Historical cost accounting for real estate assets implicitly assumes that the value of real estate assets diminishes predictably over time. In fact, real estate values have historically risen or fallen with market conditions. FFO is intended to be a standard supplemental measure of operating performance that excludes historical cost depreciation from - or "adds it back" to - GAAP net income. We consider FFO to be useful in evaluating potential property acquisitions and measuring operating performance.

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Funds available for distribution is frequently referred to as "FAD." We define FAD as FFO plus non-cash expenses, plus (less) gains (losses) from sales of property, less recurring capital expenditures. We believe that, together with net income and cash flows from operating activities, FAD provides investors with an additional measure to evaluate the ability of the operating partnership to incur and service debt, to fund acquisitions and other capital expenditures, and to fund distributions to shareholders and minority unitholders.

Funds from operations and funds available for distribution do not represent net income or cash flows from operations as defined by GAAP. Nor do FFO or FAD measure whether cash flow is sufficient to fund all of our cash needs, including principal amortization, capital improvements and distributions to shareholders and unitholders. You should not consider FFO or FAD to be alternatives to net income as reliable measures of the company's operating performance; nor should you consider FFO or FAD to be alternatives to cash flows from operating, investing or financing activities (as defined by GAAP) as measures of liquidity. Further, FFO and FAD as disclosed by other REITs might not be comparable to our calculation of FFO or FAD.

Funds from operations totaled \$3.4 million in the third quarter of 2006, a decrease of \$0.5 million, or 11.9%, compared to the third quarter of 2005. Funds from operations in the first nine months of 2006 totaled \$12.2 million, an increase of \$1.0 million, or 8.8%, compared to the first nine months of 2005. These comparisons reflect the positive impact of apartment additions and continued improvement in apartment operating results, which have been offset or reduced by the \$1.3 million charge in third quarter of 2006 for costs related to the pending merger transaction. If the merger transaction costs had not been incurred, FFO would have been \$4.7 million in the third quarter and \$13.5 million in the first nine months of 2006.

Funds available for distribution totaled \$2.7 million in the third quarter of 2006, a decrease of \$0.4 million, or 14.4%, compared to the third quarter of 2005. Funds available for distribution in the first nine months of 2006 totaled \$10.1 million, an increase of \$0.8 million, or 8.0%, compared to the first nine months of 2005. Again, we have included the \$1.3 million charge in third quarter of 2006 for costs related to the pending merger transaction in this measurement. The disparity between comparisons of FFO and FAD against prior year periods arises primarily from the impact of timing of recurring capital

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expenditures, which we deduct in our measurement of FAD. Recurring capital expenditures include operating replacements such as floor coverings, appliances and HVAC, as well as expenditures for capital replacements such as roofs and exterior paint.

We calculated FFO of the operating partnership as follows:

	Three months ended September 30		Nine months ended September 30	
	2006	2005	2006	2005
	-----		-----	
	(000's)	(000's)	(000's)	(000's)
Net loss	\$ (1,298)	\$ (150)	\$ (1,692)	\$ (1,692)
Loss attributed to minority interests	(324)	(293)	(421)	(421)
Cumulative preferred dividend	-	(250)	-	-
Casualty gains	-	(168)	(113)	(113)
Amortization of in-place lease intangibles	23	62	133	133
Depreciation, continuing operations	5,052	4,534	14,560	14,560

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	Three months ended September 30		Nine months ended September 30	
	2006	2005	2006	2005
	-----		-----	
	(000's)	(000's)	(000's)	(000's)
Depreciation related to discontinued operations	-	84	-	-
Deficit distributions to minority partners of consolidated limited partnerships(1)	90	150	270	270
Minority interest in FFO of consolidated limited partnerships	(130)	(94)	(565)	(565)
Funds from operations	\$ 3,412	\$ 3,875	\$ 12,171	\$ 12,171

A reconciliation of net cash provided by operating activities (as defined by GAAP and reflected in our consolidated statements of cash flows) to FAD follows:

	Three months ended September 30		Nine months ended September 30	
	2006	2005	2006	2005
	-----		-----	
	(000's)	(000's)	(000's)	(000's)



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Net cash provided by				
operating activities	\$ 2,965	\$ 4,298	\$ 13,409	\$
Cumulative preferred dividend	-	(250)	-	
Recurring capital expenditures	(992)	(902)	(2,933)	
Change in net operating				
assets and liabilities	752	(8)	(152)	
Minority interest in consolidated limited				
partnerships' share of reconciling items	(50)	(15)	(185)	
	-----	-----	-----	-----
Funds available for distribution	\$ 2,674	\$ 3,123	\$ 10,138	\$
	=====	=====	=====	=====

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Other information about our historical cash flows follows (all amounts in thousands):

	Three months ended September 30		Nine months ended September 30	
	2006	2005	2006	
	(000's)	(000's)	(000's)	
Net cash provided by (used in):				
Operating activities	\$ 2,965	\$ 4,298	\$ 13,409	\$
Investing activities	(6,850)	(1,456)	(21,115)	
Financing activities	2,882	(3,447)	7,128	
Dividends and distributions paid to:				
Preferred shareholders	\$ -	\$ 250	\$ -	\$
Common shareholders	2,717	2,361	8,123	
Minority partners in consolidated				
limited partnerships	90	150	270	
Minority unitholders in operating				
partnership	678	602	1,989	
Scheduled debt principal payments	705	643	2,627	
Non-recurring capital expenditures	779	1,087	4,989	
Weighted average shares outstanding during the period:				
Preferred shares	-	909	-	
Common shares	10,459	9,384	10,425	
Operating partnership				
minority units	2,609	2,408	2,585	
Shares and units outstanding at end of period:				
Preferred B shares			-	
Common shares			10,468	
Operating partnership				
minority units			2,609	

### Capital Resources and Liquidity

Net cash flows from operating activities totaled \$3.0 million in the third quarter of 2006, compared to \$4.3 million in the third quarter of 2005. Net cash flows from operating activities for the first nine months of 2006 totaled \$13.4 million, compared to \$11.4 million in the first nine months of

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2005. Cash flows from operating activities in 2006 includes the \$1.3 million payments in the third quarter of 2006 for costs related to the pending merger transaction. In addition, cash flows from operating activities in the first quarter of 2005 included \$0.5 million for penalties paid at refinance by a consolidated limited partnership.

If these two non-routine costs had not been incurred, net cash flows from operating activities would have been \$4.2 million in the third quarter and \$14.7 million in the first nine months of 2006, and \$4.3 million in the third quarter and \$11.9 million in the first nine months of 2005. The increase in comparative amounts on a year-to-date basis reflect the growth in size of

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our apartment operations, while the comparison in amounts for the third quarters of 2006 and 2005 reflect fluctuations in timing of payments for operating assets and liabilities.

In April 2006, we acquired the Sterling Bluff Apartments, a 144-unit apartment property located in Carrboro, North Carolina, for a contract purchase price of \$9.4 million, from an unaffiliated third party. We funded this acquisition by a draw on our existing revolving line of credit. We operate the apartment community as Bridges at Chapel Hill Apartments.

In May 2006, we issued a \$7.3 million fixed-rate note payable, secured by a deed of trust and assignment of rents of Bridges at Chapel Hill Apartments. The loan provides for interest at 6.22% (6.3% effective rate), with interest-only monthly payments through June 2012, then installments of principal and interest of \$45,000 per month, and a balloon payment of \$7.0 million in June 2016. We applied proceeds of this loan to reduce our revolving line of credit.

In early July 2006, we acquired the Quail Hollow Apartments, a 90-unit apartment property located in Charlotte, North Carolina, for a contract purchase price of \$5.1 million, from an unaffiliated third party. We funded this acquisition by a draw on our existing revolving line of credit. We operate the apartment community as Bridges at Quail Hollow Apartments.

Other investing and financing activities focused on capital expenditures at apartment communities, along with payment of dividends and distributions.

We have announced that the company will pay a regular quarterly dividend of \$0.26 per share, or approximately \$2.7 million, on November 15, 2006, to shareholders of record of our common stock as of November 1, 2006. We expect to pay regular quarterly distributions totaling approximately \$0.7 million to operating partnership minority unitholders on the same date.

In June 2006, we entered into an exchange agreement with Laurel Springs III, LLC and its members, pursuant to which we will acquire the Laurel Springs Phase 3 Apartments, a 168-unit apartment property that is adjacent to our Laurel Springs community. The purchase price for the property will be \$11.7 million, consisting of the assumption or refinancing of approximately \$10.1 million of debt and \$1.6 million to be paid in operating partnership units with an imputed value of \$16.70 per unit. Under the terms of the exchange agreement, we will complete the acquisition no later than January 2007, and we will issue one-half of the operating partnership units (approximately 47,000 units) in July 2007 and one-half in July 2008.

We generally expect to meet our short-term liquidity requirements through net cash provided by operations and utilization of credit facilities. We believe that net cash provided by operations is, and will continue to be,

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adequate to meet the REIT operating requirements in both the short term and the long term. We anticipate funding our future acquisition activities primarily by using short-term credit facilities as an interim measure, to be replaced by funds from equity offerings, long-term debt or joint venture investments. We expect to meet our long-term liquidity requirements, such as scheduled debt maturities and repayment of short-term financing of future property acquisitions, through long-term secured and unsecured borrowings and the issuance of debt securities or additional equity securities. We believe we have sufficient resources to meet our short-term liquidity requirements.

### Critical Accounting Policies

We identify and discuss our significant accounting policies in the notes to our financial statements included in our Annual Report on Form 10-K. Our policies and practice regarding our

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accounting for our general partner interests in limited partnerships, for acquisitions, capital expenditures and depreciation, and for stock compensation, which may be of particular interest to readers of this Quarterly Report, are further discussed below.

#### Accounting for general partner interests in limited partnerships

As managing general partner in three real estate limited partnerships, we have the ability to exercise significant influence over operating and financial policies and activities. The appropriate accounting treatment for our interests in these partnerships varies.

If the partnership is considered a variable interest entity ("VIE") and we are the "primary beneficiary," as defined by GAAP, we include the accounts of the partnership in our consolidated financial statements. We initially record all of the VIE's assets, liabilities and minority interests at fair value. We account for our interest in the Villages Partnership using this approach.

If we, as general partner, control a partnership that is not a VIE, we also include the accounts of the partnership in our consolidated financial statements. We initially record our prorata interest in the partnership's assets and liabilities at the lower of our cost or fair value; we reflect the minority partners' interest in the partnership's assets and liabilities at historical cost, except to adjust an existing deficit capital account balance to \$-0-. We account for our interests in the Marina Shores Partnership and the Villages Phase 5 Partnership using this approach.

If a consolidated limited partnership makes distributions to a minority partner in excess of the positive balance in such partner's capital account, we record a charge to our earnings for "deficit distributions to minority partners," even though the cash outlay is made by the consolidated limited partnership, and not by our operating partnership.

We allocate proportional income and losses of the consolidated limited partnerships to minority partners; however, we may allocate losses to a minority partner only to the extent of his positive capital account balance. If losses attributable to a minority partner exceed his capital account balance, we record a charge to our earnings to absorb those losses, even though our operating partnership suffers no adverse economic effect.

We may subsequently recover such deficit distributions or absorbed losses if and when the consolidated limited partnership generates positive net income.

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### Purchase price allocation for apartment community acquisitions

In connection with the acquisition of an apartment community, we perform a valuation and allocation to each significant asset and liability based on their estimated fair values at the date of acquisition. Significant tangible asset values generally include real estate investments, which we subsequently depreciate over their estimated useful lives. We include an estimate of intangible asset values, generally consisting of at-market, in-place leases, and amortize these amounts over the remaining lease terms as a reduction in reported rental income. In general, we have found that the average remaining life of in-place leases at acquisition date ranged from five to nine months, and such intangible assets represented approximately 0.1% to 0.3% of contract prices.

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### Capital expenditures and depreciation

In general, for the 16 apartment properties acquired before 2002, we compute depreciation using the straight-line method over composite estimated useful lives of the related assets, generally 40 years for buildings, 20 years for land improvements, 10 years for fixtures and equipment, and five years for floor coverings.

For apartment properties acquired after 2001, we performed detailed analyses of components of the real estate assets acquired. For these properties, we assigned estimated useful lives, based on age and condition at acquisition, as follows: base building structure, 43-60 years; land improvements, 7-20 years; short-lived building components, 5-20 years; and fixtures, equipment and floor coverings, 5-10 years.

We generally complete and capitalize acquisition improvements (planned expenditures we identify when we acquire the property and that are intended to position the property consistent with our physical standards) within one to two years of acquisition of the related apartment property. We capitalize non-recurring expenditures for additions and betterments to buildings and land improvements. In addition, we generally capitalize recurring capital expenditures for exterior painting, roofing, and other major maintenance projects that substantially extend the useful life of existing assets. For financial reporting purposes, we depreciate these additions and replacements on a straight-line basis over estimated useful lives of 5-20 years. We retire replaced assets with a charge to depreciation for any remaining carrying value. We capitalize all floor covering, appliance, and HVAC replacements, and depreciate them using a straight-line, group method over estimated useful lives of 5-10 years.

We expense ordinary repairs and maintenance costs at apartment communities. Costs of repairs, maintenance, and capital replacements and improvements at restaurant properties are borne by the lessee.

### Impairment of long-lived assets

We evaluate our real estate assets when significant adverse changes in operations or economic conditions occur in order to assess whether any impairment indicators are present that affect the recovery of the recorded values. If we considered any real estate assets to be impaired as defined by GAAP, we would record a loss to reduce the carrying value of the property to its estimated fair value. To date, there have been no such circumstances, and we consider none of our assets to be impaired.

### Revenue recognition

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We record rental and other income monthly as it is earned. We record rental payments that we receive prior to the first of a given month as prepaid rent. We hold tenant security deposits in trust in bank accounts separate from operating cash (these amounts are included in other current assets on our balance sheet), and we record a corresponding liability for security deposits on our balance sheet.

We amortize any cash concessions given at the inception of an apartment lease over the approximate life of the lease, which is generally one year or less. In general, cash concessions range from \$100 to \$300 and are taken by residents during the first two months of the lease.

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### Stock-based compensation

The company has one employee Stock Option and Incentive Plan in place, which we describe in more detail in the notes to our financial statements in our Annual Report on Form 10-K for the year ended December 31, 2005. Prior to July 1, 2005, we accounted for options granted under this plan using the intrinsic value method; no stock-based employee compensation expense was reflected in our earnings, as all outstanding options had been granted at exercise prices equal to market value of the underlying stock on the dates of grant. All outstanding options were fully vested by the end of 2004.

Effective July 1, 2005, we adopted the fair value recognition provisions of Statement No. 123, as revised in 2004 ("FAS 123(R)"), using the modified-prospective transition method. Under this transition method, compensation cost recognized in the second half of 2005 and the first quarter of 2006 includes compensation cost for all share-based payments granted subsequent to July 1, 2005, based on the grant-date fair value estimated in accordance with the provisions of FAS 123(R). Under the modified-prospective transition method, there is no compensation cost recognized for previously granted options that were fully vested prior to July 1, 2005.

### Additional information regarding capital expenditures

We provide the following information to analysts and other members of the financial community for use in their detailed analyses.

A summary of capital expenditures for our owned apartment communities during the first nine months of 2006, in aggregate and per apartment unit, follows:

	Total	Per unit
	(000's)	
Recurring capital expenditures:		
Floor coverings	\$ 975	\$ 121
Appliances/HVAC	408	51
Computer/support equipment	151	19
Other	906	113
	\$ 2,440	\$ 303
	\$ 2,473	\$ 303
Non-recurring capital expenditures:		
Acquisition improvements at apartment properties	\$ 2,473	
Casualty replacements	1,326	

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Additions and betterments at apartment properties	816
Computer/support equipment	137
	-----
	\$ 4,752
	=====

We expense ordinary repairs and maintenance costs at apartment communities. Repairs and maintenance at our owned apartment communities during the first nine months of 2006 totaled \$7.5 million, including \$2.7 million in compensation of service staff and \$4.8 million in payments for material and contracted services.

Costs of repairs, maintenance, and capital replacements and improvements at restaurant properties are borne by the lessee.

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

All of our long-term debt is secured by real estate investments. As of September 30, 2006, long-term debt, on a consolidated basis, totaled \$453.6 million, including \$388.2 million of notes payable at fixed rates ranging from 5.0% to 7.4%, and \$65.4 million at variable rates indexed primarily on 30-day LIBOR rates. The weighted average interest rate on debt outstanding at September 30, 2006, was 6.0%, compared to 5.8% at December 31, 2005. This increase is primarily attributable to steady increases in variable interest rates during the first and second quarters of 2006. A 1% fluctuation in variable interest rates would increase or decrease our annual interest expense by approximately \$0.7 million.

The table below provides information about our long-term debt instruments and presents expected principal maturities and related weighted average interest rates on instruments in place as of September 30, 2006.

	2006	2007	Expected maturity dates			Later
			2008	2009	2010	
	-----					
	(all dollar amounts in thousands)					
For owned properties:						
Fixed rate notes	\$ 544	\$ 2,254	\$41,946	\$31,247	\$20,919	\$243,768
Average interest rate	5.9%	5.9%	6.5%	5.3%	6.8%	5.7%
Variable rate notes	\$ 54	\$ 9,177	\$30,709	\$25,475	-	\$ -
Average interest rate	7.3%	7.3%	7.2%	7.1%		
For consolidated limited partnerships:						
Fixed rate notes (1)	\$ 158	\$ 664	\$ 698	\$ 743	\$ 786	\$ 43,594
Average interest rate	5.7%	5.7%	5.7%	5.7%	5.7%	5.8%

### Item 4. Controls and Procedures

We maintain disclosure controls and procedures designed to ensure that information disclosed in our annual and periodic reports is recorded, processed,

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summarized and reported within the time periods specified in the SEC's rules and forms. In addition, we designed these disclosure controls and procedures to ensure that this information is accumulated and communicated to our management, including our chairman, chief executive officer and chief financial officer, to allow timely decisions regarding required disclosures.

Based on our most recent evaluation, which was completed as of the end of the third quarter of 2006, our chairman, chief executive officer and chief financial officer believe that our disclosure controls and procedures are effective. There were no changes in our internal control over financial reporting identified in connection with our third quarter 2006 evaluation of such internal control that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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### Part II - Other Information

#### Item 6. Exhibits

The Registrant agrees to furnish a copy of all agreements related to long-term debt upon request of the Commission.

Exhibit No.	Description
10.1	Employment agreement dated August 31, 2006, between BNP Residential Properties, Inc. and Philip S. Payne
10.2	Employment agreement dated August 31, 2006, between BNP Residential Properties, Inc. and D. Scott Wilkerson
10.3	Employment agreement dated August 31, 2006, between BNP Residential Properties, Inc. and Pamela B. Bruno
10.4	Employment agreement dated August 31, 2006, between BNP Residential Properties, Inc. and Eric S. Rohm
31.1	Rule 13a-14(a)/15d-14(a) Certification by Chairman
31.2	Rule 13a-14(a)/15d-14(a) Certification by Chief Executive Officer
31.3	Rule 13a-14(a)/15d-14(a) Certification by Chief Financial Officer
32.1	Section 1350 Certification by Chairman, Chief Executive Officer, and Chief Financial Officer

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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.

BNP RESIDENTIAL PROPERTIES, INC.  
(Registrant)

November 6, 2006

/s/ Philip S. Payne  
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Philip S. Payne  
Chairman

November 6, 2006

/s/ Pamela B. Bruno

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Pamela B. Bruno  
Vice President, Treasurer and  
Chief Financial Officer

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31.3	Rule 13a-14(a)/15d-14(a) Certification by Chief Financial Officer
32.1	Section 1350 Certification by Chairman, Chief Executive Officer, and Chief Financial Officer

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