FINAL TRANSCRIPT

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EXR - Q2 2009 EXTRA SPACE STORAGE INC Earnings Conference Call

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PRESENTATION

Operator

Good day, ladies and gentlemen and welcome to the second quarter 2009 Extra Space Storage earnings conference call. My name is Dan, and I will be your coordinator for today. At this time all participants are in listen-only mode. We will conduct a question-and-answer session towards the end of this conference. (Operator Instructions) As a reminder, this conference is being recorded for replay purposes.

I would now like to turn the presentation over to your hose for today's call, Mr. James Overturf from Extra Space Storage. Please proceed, sir.

James Overturf - *EXTRA SPACE STORAGE INC*

Thanks, Dan. Welcome to Extra Space Storage's second quarter 2009 conference call. With us today are CEO and Chairman of the board, Spencer Kirk, CFO, Kent Christensen and CO, Karl Haas. In addition to our press release, we have also furnished unaudited supplemental financial information on our website. Please remember that management's prepared remarks and answers to your questions contain forward-looking statements as defined in this Private Securities Litigation Reform Act of 1995, forward-looking statements address matters which are subject to risks and uncertainties that may cause actual results to differ from those discussed today. Examples of forward-looking statements include statements related to Extra Space Storages development acquisition programs, revenues, net operating income, FFO and forward looking guidance. We encourage all of our listeners to review a more detailed discussion related to these forward-looking statements contained in the company's filings with the SEC. These forward-looking statements represent management's estimates as of today, August 4, 2009. Extra Space Storage assumes no obligation to update these forward-looking statements in the future because of changing market conditions or other circumstances. I would now like to turn the call over to Extra Space Storage's chairman and CEO, Spencer Kirk.

Spencer Kirk - *EXTRA SPACE STORAGE INC - Chairman & CEO*

Hello, everyone. Joining me today are Kent Christensen, our CFO and Karl Haas, our Chief Operating Officer. I'll give a brief summary of the second quarter and then hand it over to Kent and Karl for the financial and operational details. As we entered the second half of 2009, we see a challenging landscape, but believe that Extra Space will continue to hold its own. Despite the thought that the storage industry may not have a rental season, people are still utilizing self storage as evidenced by the 87,000 units that we rented throughout our platform in the second quarter. Our business may be reaching a trough given that turn around in move outs and the stabilization of our same store occupancy. I'm reluctant to call this trend an inflection point. In fact, we don't have much visibility as to how long we could an bounce along at these levels. Pricing is weak and in my opinion will continue to be soft in the near term. However, with that said, we believe that we have the systems in place that will enhance our pricing decisions and we will continue to do an excellent job of holding down expenses to maximize our margins as we wait for the top line to recover.

For the quarter, same store revenue was down 3%, expenses were down 3.2%, which generated a same-store NOI of minus 2.8%. Same store occupancy finished the quarter at 84.3%, down 2.7% compared to 2008. As of the end of July, this variance improved by 0.5% to being down 2.2%. Excluding one-time charges, FFO per share was $0.24, in line with our estimate. Before adjustments, we reported FFO of $0.07 per share.

Since the beginning of the year, we've taken steps to firmly position Extra Space in a difficult capital environment. We've reduced our dividend. We're winding down our development program. We're advancing a joint venture with Harrison Street which will enable us to delever by 275 million and we've addressed our debt maturities through early 2012 with additional financing. I would now like to turn the call over to Karl Haas, our Chief Operating Officer, to discuss operations.

Karl Haas - *EXTRA SPACE STORAGE INC - COO*

Thanks, Spencer. At the risk of sounding like a recording on a three-month delay, on our last call, I opened my remarks telling you that the first quarter was tougher than Q4, 2008. I can say today that in the second quarter, the operating environment has proven to be as tough. However, as Spencer said, our move outs are lower and in fact reversed in the quarter. We had a positive variance in April after nine months of increased move out activity. The ongoing challenge during the quarter was trying to match up our pricing with a lower level of demand. As of quarter end, we are running 2.7% below last year's occupancy, compared to minus 2.5% at March 31. Most of the occupancy loss came in April as May and June were much better and we actually closed the gap a bit. Low pricing leverage is our greatest challenge.

The impact of the consumer's "everything on sale" mentality is apparent in our same store results. Revenues were down 3% and NOI was down 2.8% in the quarter compared to last year. We were able to somewhat mitigate the erosion in the same store net NOI by having a 3.2% decrease in expenses. As we move forward, this level of expense control will be harder and harder to achieve and at some point we need to have better pricing on incoming tenants.

We talk about storage demand being driven by need. We feel that over the last year, we have been impacted by some of the need drivers dissipating. One of the most important being the velocity of household moves. We've also been seeing a lot of discretionary renters vacating as their finances became more stressed and they had to tighten their spending. The good news is that we have seen the higher vacate trend that we experienced for nine months going back to July 2008, turn around in April, and the lower year-over-year vacates have continued through July. As far as rentals, they are running below last year as they have for the last several months. As already mentioned, we continue to be aggressive in our pricing and specials so we don't miss any sales opportunities. We are convinced that overall, demand is down and the demand pie is smaller right now by 5% to 10%. To make progress on closing our occupancy delta, we need to be aggressive in price.

For the quarter, northern California, Washington, D.C. metro area, Boston and Dallas were our best markets, Florida continues to be our worst overall macro market and southern California is trending negatively. We continue to diligently work on determining and achieving the optimal mix of revenue versus occupancy. We are performing statistical pricing tests at our properties and not surprisingly, the lower the pricing, the higher the demand. Our top priority right now is turning around the negative square foot occupancy delta. We are convinced that the higher occupancy level will be advantageous when the market returns. Our call center which continues to improve in sales conversions also provides us with an insight into that pricing mix and enables us to continue to test different pricing strategies in a controlled environment.

The internet as we know it is rapidly evolving. The days of generic search terms such as "mini storage" and "self storage" are fading rapidly. Perspective customers are using more and more localized search terms such as "climate controlled self storage in Hoboken, New Jersey." Smart phones are becoming the norm and growth in mobile search and advertising is becoming much more important. We are aggressively finding more ways of using these marketing channels and shifting more and more of our advertising from conventional print yellow page ads to web-based marketing. On the positive side, we are continuing to see lower year-over-year bad debts and accounts receivables are comparable to the same time last year and, in fact, they are lower than 2007. The results are very little new competition for our properties. The number of new self storage facilities impacting our portfolio is at an all-time low and this bodes well for the future.

Occupancy also appears to be stabilizing. There is no question, April was not a good month for us, however, May, June and July have reflected net rentals above the same months in 2008 and we did have a healthy busy season. It just started in May versus April this year. We have had to be aggressive on rates and the lower rates are putting pressure on our overall revenues. The good news is there is still healthy demand out there. In spite of our best efforts in using technology to impact operations, the potential signs of some sort of bottoming, our outlook for the balance of 2009 is still unclear. Our team has been tireless in their execution, and it is our expectation, that they will continue to chase down sales opportunities and tow the line on expenses. With that I want to turn it over to Kent Christensen, our CFO.

Kent Christiansen - *EXTRA SPACE STORAGE INC - CFO*

Thanks, Karl. Let me first give an update on where we are on the balance sheet and then I'll get to the earnings and guidance for the remainder of the year. As Spencer mentioned, we continue to make significant headway in our efforts to satisfy our near term maturities. We closed on nine loans equaling $97 million of financings in the quarter and another four loans equaling $48 million since the quarter end. These loans bring our year to date total of new financings to $212 million. In addition to that, we closed on one joint venture loan with our [Heightman] joint venture of $60 million subsequent to the end of the quarter. Our treasury and legal teams have done an excellent job getting these loans over the finish line.

The terms on our most recent loans have been in line with what we have shared in the past with loan to values of 60% to 70%, spreads over LIBOR between 250 and 300 basis points and floors between 5% and 6.25%. The maturities on these loans range from three to ten years. Our weighted average maturity years on our debt last June was 5.6 years. The loans we have closed have a weighted average maturity of 6.25% -- 6.25 years. The average interest rate of our debt last June was 4.9%. The average interest rate on the loans that we have closed is 6.2%. When we add the debt -- this debt to our existing debt, we have extended the length of time on our maturities by four months while increasing our weighted average interest rate by only 20 basis points. We continue to put loans on our unencumbered properties to address our 2011 maturities and beyond and we currently have 79 million in signed term receipts on stabilized properties and 40 million on development properties which we expect to close by the end of the third quarter. With these completed financings, we will have addressed all of our maturities through the end of 2011.

We currently have 33 unencumbered properties that are wholly owned on which we can place the loans. This number will increase to 59 properties when we pay back the $111 million CMBS loan later this quarter. The total estimated loan to value of these properties is 275 -- $279 million, assuming a 70% loan to value and a 7.5 Cap. Some of the closings in the second quarter and so far in the third quarter are construction loans. We closed two construction loans in the second quarter for a total of 8 million and have closed one loan in the third quarter for a total of $7 million. We are going through the loan process on seven additional projects equally approximately $40 million. At this time we need $68 million to complete the development projects of which we have $40 million of potential loans. It is important to note that with the exception of a covenant on our undrawn $50 million Banc of America line, none of our debt has any corporate level covenants.

The Harrison Street joint venture continues to work towards closing. This transaction is an example of one of the ways in which we can improve our leverage ratios without sacrificing operating scale. In this environment we are cognizant of the impact of leverage on our business. We can reduce our overall leverage in several ways. For instance, in the quarter, we were able to repurchase $43 million in our -- of our convertible bonds resulting in a gain of $0.06 a share and bringing in the total purchases to roughly $155 million and a total gain of approximately $36 million. This leaves a balance on our convertible bonds of $95 million which are due in 2012. The second way we -- through which we can reduce our debt is through the reduction of our dividend. With the gain on the bonds and the dividend reduction, we have reduced our overall debt by $55 million this year. So, as you can see, there are other ways in which we can also reduce our debt, which is by selling properties into joint ventures, selling our properties outright or selling equity in the company. As you can see, we have many levers we can pull to reduce our overall leverage. We believe our leverage percentage will improve through the growth in our EBITDA. We currently have 30 properties in some stage of lease up and when those properties reach stabilization, it will generate approximately $0.25 cents of additional FFO. And in addition to that, our overall store performance will improve in time which will also have a positive impact.

In terms of forward-looking guidance, attempting to predict the future in these unprecedented times is difficult at best. When we gave our estimates on the first quarter earnings call, we had forecasted higher pricing than what we've experienced and a bit of a pickup in the fourth quarter. Instead, what we've seen is our top line come under more pressure as a result of lower pricing and minimal occupancy gains. We are also less sure about a potential upturn in the fourth quarter. We are now forecasting our same store revenue for the year to be down in the negative 3% to 5% range. This when combined with approximately $0.02 in potential decline in our equity and earnings and interest income leads us to an estimate that our annual FFO could be between $0.85 and $0.92 per share, including dilution on our recently opened development properties of approximately $0.07. For the third quarter, we estimate our FFO to be between $0.20 and $0.32(Sic-see press release). The annual FFO estimate excludes the potential dilution from our Harrison Street joint venture of approximately $0.02 per quarter when that transaction closes. And it also includes the $0.28 gain on the early extinguishment of debt and the $0.22 writedown on our development program and adding back the non-interest expense of our exchangeable notes. For further assumptions on our guidance, please refer to our earnings press release. With that, I'd like to turn the call back to Spencer.

Spencer Kirk - *EXTRA SPACE STORAGE INC - Chairman & CEO*

Thanks, Kent. Before we begin Q&A, I'd like to leave you with some thoughts. Given our same store performance and estimates for the rest of the year, a number of you are wondering if the thesis of recession resistance for self storage still holds true. Let me take a moment to prime a thesis for you. This recession that began by some accounts 18 months ago has presented self storage with a chance to prove itself as an industry. Operating fundamentals is measured by four public companies, we made positive until Q1 of this year. Thin about that fact. For over 18 months in the worst recession in nearly 80 years, self storage remained positive. This says a lot. Even now, our top line growth is forecast to decrease by 4% plus or minus a percent. This moderate deterioration compares extremely well to other real estate sectors. As I'm sure you've seen in your own lives, people are still going through life changes that predicate a need for self storage and they are renting self storage units. Nearly 90,000 new rentals in Q2 alone tells us that this is the case.

Rents are lower. As we've said and I'm sure it is not original, but self storage is on sale. Our asking rates are roughly 11% lower across the country than they were a year ago. Through our revenue management program, we've been able to vigorously test various pricing strategies. The good news is that the lower prices have helped. The bad news is the near term outlook for a price increase is difficult. However, on the positive side, our short-term lease duration, i.e. month to month lease,s and 20,000 to 30,000 rentals per month, enables us an immediate ability to increase rates as conditions improve. Though gross rentals were lower than previous rental seasons, we've held our own and had higher net rentals than last year. Move outs, which were tracking higher on a year to year comparison for nine straight months have gone into positive territory since April.

On the financing and capital markets side of the business, we are making excellent progress. Since the beginning of the year, we have obtained over $200 million of financing, we have retained over $45 million from adjusting our dividend and we have entered into the Harrison Street JV which will be a $275 million delevering event at closing. This has not been easy, but we believe we are making the right decisions to fortify our balance sheet and to maintain financial flexibility. Though we are not actively in the acquisition market at this time, Extra Space is a growth company and we are continuing to grow and enlarge our brand by providing management services to third-party owners through our three plus management program. We recently brought on 40 properties into our three plus platform and are pleased with the traction. Three plus offers a way for Extra Space to grow without excessive G&A commitments and provides third-party owners access to the best operational, marketing, revenue and technology systems in the industry. In the last 12 months, we have gone from 673 stores to 738 stores, a 10% increase in the stores flying the Extra Space flag. Not only are we increasing our footprint through a three plus, but we will also be realizing the FFO of our development pipeline that will deliver approximately $0.25 per share of earnings as these properties reach stabilization.

I became involved in the self storage industry due to its diversification and resistance to economic downturns. This downturn has not caused me to pause regarding my decision. Self storage remains an investment that continues to prove to be a solid performer in both expanding and contracting economic cycles. I look forward to the future. I am positive about the future and I am now glad to take questions that you might have.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of David Toti from Citi. Please proceed.

David Toti - *Citigroup - Analyst*

Good morning, guys. Michael Bilerman is here with me as well. My first question has to do with the price competition and are you seeing any material change in behavior of the private owners? I know they were holding steady for some time and not really adjusting prices. Have you seen any change in that level?

Karl Haas - *EXTRA SPACE STORAGE INC - COO*

This is Karl. They have come down some. They've reacted. They certainly have been slower to react than our other competitors, but there has been some drop, but not as dramatic as us.

David Toti - *Citigroup - Analyst*

And how aggressive have your public competitors been relative to your pricing?

Karl Haas - *EXTRA SPACE STORAGE INC - COO*

It really depends. You know, it kind of varies based on the public competitors. Some of them have not moved very much, you know, or not moved as much as us and some of them have moved almost as much as us.

David Toti - *Citigroup - Analyst*

Okay, and relative to regional performance, could you provide a little bit more detail on what you're seeing in your southern California assets in terms of, you know, how the performance -- how the portfolio is performing relative to the average, what's the customer behavior like? Are you having to discount any more deeply there or less deeply?

Karl Haas - *EXTRA SPACE STORAGE INC - COO*

Well, from a pricing standpoint, we're continuing to be very aggressive there. From a discount, you know, we're really still doing the same -- you know, in southern California as we're doing everywhere else as far as the actual, pricing -- what specials we offer. We're still offering just one month free there. Not really going much beyond that. From a rate standpoint, our -- you know, our rates there are probably down a little bit more, a couple of points more than some of the other markets.

David Toti - *Citigroup - Analyst*

Okay. And then my last question has to do with your three plus program. Can you quantify sort of what the upside is to that in your expectations relative to size of the program, capacity of management, of facilities managed and whether or not the infrastructure you have in-house now is able to be scalable?

Spencer Kirk - *EXTRA SPACE STORAGE INC - Chairman & CEO*

This is Spencer, David. Let me take the second half of that question first. One of the things that we have done well at Extra Space is build a scalable platform and I don't think that the ability to swallow a considerably larger amount of properties in a large footprint is going to be the challenge. We're geared for that and I think our track record over the last 11 years points to that. The question as to what it could become remains to be unseen. This is a relatively new program, formally kicked off August of last year and we're just starting to get traction and I think as we get better visibility as to what it can become, we'll be talking to you and your colleagues about it, but I would hate to prognosticate today on something that is new. We are hopeful, we are optimistic, but it's too early to tell.

David Toti - *Citigroup - Analyst*

Okay. Thanks for all the detail today.

Operator

Your next question comes from the line of Todd Thomas from KeyBanc Capital Markets. Please proceed.

Todd Thomas - *KeyBanc Capital Markets - Analyst*

Yes, hello, I'm on with Jordan Sadler and looking at your revised guidance, you lowered same store NOI by about 50 basis points, but you lowered your full year FFO by about $0.055, excluding the dilution from the JV potentially later this year. I don't really see anything else that changes much outside of the core, so can you just help me reconcile that change in FFO guidance?

Kent Christiansen - *EXTRA SPACE STORAGE INC - CFO*

Todd, this is Kent. In the guidance we gave earlier in the year, as we stated, the range that we gave on the revenue side are a range that didn't completely correspond with the range we gave in our FFO guidance, meaning that a very negative aspect on revenues would have produced a lower amount of FFO. As we've further analyzed this and looked at where we're at, we wanted to be more realistic on the ranges we gave on our revenue side and the ranges that we're giving in FFO, so there's more of a correlation there. So, what you see now is that the high and the low of our range does correspond with the high and the low of our FFO guidance, whereas last quarter, there -- as I stated, there wasn't a direct correlation between those two numbers.

Todd Thomas - *KeyBanc Capital Markets - Analyst*

Okay. And, Karl, you mentioned that demand is down and then also that the demand pie is down 5% to 10% overall. Can you just elaborate on that?

Karl Haas - *EXTRA SPACE STORAGE INC - COO*

I've got to admit that's more of a guess than, you know, than a firm -- I don't have data to prove that. It's more our guesstimate based on what we're seeing and really the only way we can explain -- we've been very, very aggressive on rates and yet it's been a struggle to gain occupancy. And, also, I guess, the SSA -- SSDA -- SSDS data that shows that overall demand is down about 7%.

Todd Thomas - *KeyBanc Capital Markets - Analyst*

Okay. And then, lastly, you mentioned that the leasing season got off to a slow start, that it really just began in May. Do you expect that it will extend further into the year or, you know, it's still -- it will just be a shorter peak leasing season?

Karl Haas - *EXTRA SPACE STORAGE INC - COO*

Well, you know, April is just -- April was a bad month and we saw just -- we didn't have the gains that you would normally expect in April. May, June and July, so far, have -- each of those months have -- net rentals have exceeded the prior year and, you know, and I doubt whether -- we're not expecting it to be August and September or August to replace what would normally be April, we're expecting more kind of a normalized -- it's just that it started a month late and we really can't explain what happened in April.

Todd Thomas - *KeyBanc Capital Markets - Analyst*

Right. But what month historically is it when you see move outs -- net move out months?

Karl Haas - *EXTRA SPACE STORAGE INC - COO*

You know, really, August and September.

Todd Thomas - *KeyBanc Capital Markets - Analyst*

Okay. Okay. Thank you.

Operator

Your next question comes from the line of Michael Salinsky from RBC Capital Markets. Please proceed.

Michael Salinsky - *RBC Capital Markets - Analyst*

Good afternoon. I think Spencer in your comments you mentioned new leases were down about 11%. Where are renewals right now and what is the delta between the amount of roll down you're seeing in the portfolio from new leases essentially?

Spencer Kirk - *EXTRA SPACE STORAGE INC - Chairman & CEO*

It's -- go ahead.

Karl Haas - *EXTRA SPACE STORAGE INC - COO*

I'm not sure where that number came from. Our -- during the quarter our rentals were down a little bit -- I think a little bit less than 5%, not 11% and -- but vacates were also down around 5%.

Michael Salinsky - *RBC Capital Markets - Analyst*

I'm asking more so as to the rate question, how much are, you know, street rates versus renewal rates?

Spencer Kirk - *EXTRA SPACE STORAGE INC - Chairman & CEO*

Well, overall, the street rates are down -- I'm sorry, say that again.

Michael Salinsky - *RBC Capital Markets - Analyst*

I'm just asking you specifically, if you look at -- how much are rates on new leases down year over year versus how much are you pushing renewal increases at this point and also what is the delta between your portfolio currently and where street rates are currently?

Spencer Kirk - *EXTRA SPACE STORAGE INC - Chairman & CEO*

Okay. The gap is about $18. Street rate is about 112 and the existing customer rates is about 130.

Michael Salinsky - *RBC Capital Markets - Analyst*

Okay.

Kent Christiansen - *EXTRA SPACE STORAGE INC - CFO*

This is Kent. That's improved since the end of the first quarter. So, we've made some progress on that number compared to where we were at the end of the first quarter.

Spencer Kirk - *EXTRA SPACE STORAGE INC - Chairman & CEO*

Yes, on the gap.

Kent Christiansen - *EXTRA SPACE STORAGE INC - CFO*

On the gap.

Michael Salinsky - *RBC Capital Markets - Analyst*

Okay. So, in a percentage basis, street rates are off, and you're saying roughly 9% -- and your renewal increases you're pushing along to customers who are --

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Kent Christiansen - *EXTRA SPACE STORAGE INC - CFO*

In a range of about 7%.

Michael Salinsky - *RBC Capital Markets - Analyst*

About 7%, okay. Secondly, you guys have --

Spencer Kirk - *EXTRA SPACE STORAGE INC - Chairman & CEO*

Sorry about having a difficult time --

Michael Salinsky - *RBC Capital Markets - Analyst*

No problem. Second question there, you talked -- you've made substantial progress in addressing refinancings I think through early 2012 I think you mentioned now. Where do you see the target leverage for the portfolio right now? Once you guys cycle through all the refinancings and everything, where do you guys want to end up at?

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Kent Christiansen - *EXTRA SPACE STORAGE INC - CFO*

Well, this is Kent. My -- the question implies a trying to come up with a determination of how you figure out what the -- how you calculate the leverage level. As you know, there's many different ways of calculating that. You can do it based on your current stock price, you can do it based on a future stock price, you can base it on a NAV, you can base it on a gross asset test. From our perspective, we believe that a proper way of looking at this is based on a cap rate on our assets that we think is a proper cap rate. And then based on that, gives us a value of all of our assets and a debt level that we feel like should be appropriate for the assets based on a proper cap rate and that being the case, we would hope to operate at a 40% to 50% leverage level if the cap rate is at proper cap rate.

Michael Salinsky - *RBC Capital Markets - Analyst*

Okay. And where is a proper cap rate these days?

Kent Christiansen - *EXTRA SPACE STORAGE INC - CFO*

Well, we think it should be a 6% cap rate, but -- no, I'm kidding. It's -- what we're seeing in the marketplace is it's somewhere between 7.5% and 8.5%. I mean there -- very little is trading and what is trading, some of the stuff that's trading is not stuff that you can really say is comparable. So -- but the appraisals that we're getting in on our loans are coming in between 7.5% and 8.5%, so -- and our Harrison Street deal is right around -- in the high 7s, so it's somewhere between 7.5% and 8.5% today and that's from the data that we have. And lots of banks and others are trying to argue that it's higher than that, but we're not seeing any data that's saying that the numbers are higher than that yet.

Michael Salinsky - *RBC Capital Markets - Analyst*

Okay. And finally, in terms -- in terms of the development pipeline, you kept the dilution expected it -- drag at -- I think $0.07, yet you indicated rental rates were continuing to erode down further. Just curious what you're seeing in the development pipeline right now in terms of the ability to hold rates and how yields are performing relative to expectations?

Kent Christiansen - *EXTRA SPACE STORAGE INC - CFO*

On the properties that are open and they're filling up, I'd have to say our rental rates on those are down compared to what we have pro formad. Obviously on the properties that haven't opened yet, many of those we have revised the projections of those already because we know the rates are down. So, those have been revised. So, when they open, we hope they'll open at rates that will be comparable to what we hope they'll be because of the revisions that we've made. In the discussion that we said that there's $0.25 cents of build -- there's FFO there that's not there yet, it includes the revisions that we've made on those properties that haven't opened up and it -- but it doesn't include -- and it also reflects the current rental rates we're getting on the properties that are open, which are lower than what we expected.

Karl Haas - *EXTRA SPACE STORAGE INC - COO*

But overall, the run up, the actual occupancy gains in those properties are doing fairly well.

Michael Salinsky - *RBC Capital Markets - Analyst*

Okay. Thank you.

Operator

Your next question comes from the line of Ki Bin Kim from Macquerie. Please proceed

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Ki Bin Kim - *Macquerie - Analyst*

Hello, thank you. Just to go back to your guidance, is it correct if you're assuming a 5% to 7% same store NOI decrease for 2009, are you really expecting around a high single digit maybe 10% decline in third quarter and fourth quarter to come in within range?

Spencer Kirk - *EXTRA SPACE STORAGE INC - Chairman & CEO*

Let me address this if I can. These are unprecedented times and the environment in which we're operating is very fluid. What we're trying to do is be conservative and realistic on potential upside and down side possibilities. We've been aggressive on our pricing and in doing so, we've closed the occupancy variance, but obviously it's had a detrimental affect on the top line. What I'd say at the end of the day, it's impossible for us to forecast where it will all settle out. Bottom line as the CEO, I'm committed to providing and communicating what we know to be in an accurate and a conservative fashion and we just don't have the visibility and so we have broadened the range and said there are too many possibilities, but this is where we think the possibilities could exist. So, only time will tell.

Ki Bin Kim - *Macquerie - Analyst*

Okay. And also, can you give a little more color on you said May, June and July was a lot better than the beginning of the year. What were street rates in the beginning of the year or maybe at the end of the first quarter compared to the 112 that you gave?

Spencer Kirk - *EXTRA SPACE STORAGE INC - Chairman & CEO*

Street rates at the end of the first quarter?

Ki Bin Kim - *Macquerie - Analyst*

Yes.

Kent Christiansen - *EXTRA SPACE STORAGE INC - CFO*

They were down about 10%. Actually at the end of the first quarter, it really wasn't that much different than at the end of June we were down about 12%.

Ki Bin Kim - *Macquerie - Analyst*

Got you. And last question. Any change you're seeing in terms of bad debts or customers leaving facilities unannounced?

Karl Haas - *EXTRA SPACE STORAGE INC - COO*

No. I mean if anything, as we said, it's probably improved. We actually had seen our vacates decrease somewhat from the prior year and as I said in my commentary, you know, that we had had a number -- you know, a number of months where our vacates had increased and starting in April, they actually decreased.

Spencer Kirk - *EXTRA SPACE STORAGE INC - Chairman & CEO*

You know, the other thing I probably ought to correct or at least clarify is that when I was talking about April, not, you know, starting the busy season. April was a positive net rental month for us, it just wasn't anywhere near as good as the prior year.

Ki Bin Kim - *Macquerie - Analyst*

Got you. Okay. Thank you.

Operator

Your next question comes from the line of Paula Poskon from Robert W Baird. Please proceed.

Paula Poskon - *Robert W Baird - Analyst*

Thank you very much. Good afternoon. A couple of housekeeping items. First, the share count that's encompassed by guidance, I just want to clarify, that does not include the impact of any contemplated common stock dividend that may happen later in the year; is that correct?

Kent Christiansen - *EXTRA SPACE STORAGE INC - CFO*

That is correct, Paula.

Paula Poskon - *Robert W Baird - Analyst*

Thanks, Kent. And what is the genesis of the expected tax expense in the TRS?

Kent Christiansen - *EXTRA SPACE STORAGE INC - CFO*

The increase in the effectiveness of our tenant insurance program has caused for more taxes for us to have a higher tax expense than we previously had.

Paula Poskon - *Robert W Baird - Analyst*

Okay. And on that topic, where does the penetration of tenant (inaudible) stand in the portfolio right now?

Karl Haas - *EXTRA SPACE STORAGE INC - COO*

Its about -- we're approaching about 53% on an overall basis.

Paula Poskon - *Robert W Baird - Analyst*

Thanks, Karl. And just moving to operations a little bit, are you seeing any change in late fees or are people paying later, are you having any change in credit card declines or anything like that?

Karl Haas - *EXTRA SPACE STORAGE INC - COO*

No. We really haven't. I actually -- on the credit card declines, I'm not sure that I -- you know, that I -- I haven't heard anything and it's not something I really keep track of, but as far as our bad debt expense is -- continues to be lower than the prior year and our receivables were basically flat with the prior year and the prior year we were actually down from -- you know, considerably down from 2007.

Paula Poskon - *Robert W Baird - Analyst*

That's helpful. Thanks. And in terms of the moderated expense growth outlook, what's driving that?

Karl Haas - *EXTRA SPACE STORAGE INC - COO*

You know, a concentrated effort. I mean one thing we -- you know, we suspended all pay rate adjustments or pay rate increases in 2009 just because of the current market conditions and as well as we've been continuing to review the staffing at our properties and really starting last September we really started a project of going through and we call it right staffing, but bringing our properties to the right level of staffing. So, you know, we have been able to control those costs. At the same time, our health insurance costs have gone up minimally, so that has helped and in every expense category, we have -- you know, we've continued to, you know, aggressively work at reducing expenses. I will say, you know, the one we haven't -- we really haven't -- you know, we're flat and we're trying to be careful of is repairs and maintenance, we continue to spend the comparable levels because we think it's important to keep the quality of our properties up, keep the gates working and having the things the customers need when they come into the facility.

Paula Poskon - *Robert W Baird - Analyst*

What are you seeing on real estate taxes and also on insurance renewals?

Kent Christiansen - *EXTRA SPACE STORAGE INC - CFO*

I can speak to that, Paula, this is Kent. On the real estate tax side, as of right now, we have not seen any substantial increases from any states or municipalities where we have substantial groups of properties. We haven't seen declines, but we haven't seen any substantial decreases. So, right now we're -- where we've got in our budget an increase on property tax of a small amount, but it could be that those come in flat and we just don't know because it will be in the next two quarters where we find out exactly what the full impact of that will be. On the property insurance side, we've had a very good year. Our property insurance costs came down last year in the middle of the year and we're seeing the full -- the benefit of that. Our renewal is kind of halfway through the calendar year, so halfway through last year, we had a decrease, which has given us a decrease into the first half of this year and our renewal of our property insurance this year was almost exactly the same as it was last year. So, we're not -- we know that we're not going to have any kind of an increase, in fact, a decrease on our property insurance for this calendar year.

Paula Poskon - *Robert W Baird - Analyst*

Okay. That's very helpful. Thanks. And then could you give a little bit more color on what's happening with the cost of internet marketing? We're hearing that the pricing is getting very aggressive very quickly.

Karl Haas - *EXTRA SPACE STORAGE INC - COO*

I can't say that we've seen anything dramatic in that area. It's gone up, but, you know, we're continuing -- it's -- you know, the great part about internet marketing is that you can, you know, so clearly measure the effectiveness and so if it -- and I don't have the numbers in front of me and it probably has been going up and we're spending more money in it, but it's still the bang for the buck and the return on investment continues to be very, very strong.

Paula Poskon - *Robert W Baird - Analyst*

That sort of leads me to the three plus efforts. I know that's been a big emphasis this year. What kind of activity are you seeing there, interest from independents and just anecdotally kind of what kind of color are you hearing from the independents?

Spencer Kirk - *EXTRA SPACE STORAGE INC - Chairman & CEO*

This is Spencer, Paula. I think the answer to your question is the interest level is high. The incubation period is long and what drives someone to come to us generally is a balance between an interest in the web and a call center and the national accounts marketing and sales efforts that drive traffic to the sites and perhaps some disenchantment with their existing management company. It's not one or the other. It seems to be a hybrid and it takes both, in my opinion, to get someone to be dislodged and say, you know what, we're going to do it, but we are making considerable progress. It just takes time to incubate it. But since August, we've added more than 60 properties under the three plus program and we continue to build momentum.

Paula Poskon - *Robert W Baird - Analyst*

That's helpful color, thank you, Spencer. And then finally just turning to development, obviously you've announced the strategic exit out of development, but clearly there's still a hefty pipeline left. Could you review for us which projects have -- how many projects have gotten started and how many remain that you still plan on starting?

Karl Haas - *EXTRA SPACE STORAGE INC - COO*

In our supplemental, there's a lot of information about that, Paula. I think there's about 15 that are still left. We've just actually in the last 30 days in July opened four properties. We have two that are opening this month and then with that, I think we have about ten to twelve that are still remaining to be opened that will open this year into next year. With that, as you know, we wrote off a number of projects that we had in our pipeline, but we took a one charge for the writeoff of a number of projects that we've walked away from and canceled the contracts on those. And so the ones that we've outlined in our supplemental are the ones that we're going to finish and that will be the only ones that we're doing.

Paula Poskon - *Robert W Baird - Analyst*

And just sort of taking a step back and looking longer term when we talk about if -- you know, if all of those development properties were fully stabilized, it would add about $0.25 in FFO, how long do you think it's going to take before the dilution actually burns off given your revised expectations on the pro formas for some of the newer properties?

Spencer Kirk - *EXTRA SPACE STORAGE INC - Chairman & CEO*

It's three to four years.

Paula Poskon - *Robert W Baird - Analyst*

Three to four years. And then just one final house keeping question, what's your expectation for capitalized interest this year? I assume that's changed given the -- you know, given the development changes as well.

Spencer Kirk - *EXTRA SPACE STORAGE INC - Chairman & CEO*

This year it's about the same because with the -- we have all the same number of projects that are ongoing. Next, year it will be decreasing as we go throughout the year. But the first part of the year it will be the same. It will drop off in the last part of the year.

Paula Poskon - *Robert W Baird - Analyst*

That's all I have. Thanks, gentlemen, very much.

Karl Haas - *EXTRA SPACE STORAGE INC - COO*

Thank you.

Operator

Your next question comes from the line of Michael Knott from Green Street Advisors. Please proceed.

Michael Knott - *Green Street Advisors - Analyst*

Hey, guys, can you just give us a little color on your thought process on the advertising line item? Obviously that was down and was part of the expense control initiative that helped during the quarter. Can you just help us understand how you evaluate the tradeoffs of reduced spending there given the occupancy weakness and weak tenant demand?

Kent Christiansen - *EXTRA SPACE STORAGE INC - CFO*

Yeah. Almost all of that relates to last year we spent somewhere in the range of about $1million on TV advertising and we did not feel we got much of a return on that last year for -- you know, as far as return on investment and so we haven't done that this year. We expect to shift a little bit more of that money into internet advertising in the third and fourth quarter. So, we probably won't continue. Our plan is not to be substantially under the prior year on a go-forward basis, but this quarter last year was when we had most of the TV advertising hit.

Michael Knott - *Green Street Advisors - Analyst*

Thank you.

Operator

Your next question comes from the line of Paul Adornato from BMO Capital Markets. Please proceed.

Paul Adornato - *BMO Capital Markets - Analyst*

Yes. I just have one additional question and Spencer, you talked a little bit about the recession resistant qualities of storage in your remarks. I was wondering if you could also address the notion that storage is a lagging indicator to the economy and that some of the weakness that we're just starting to see might really just be the start of weakness in the industry?

Spencer Kirk - *EXTRA SPACE STORAGE INC - Chairman & CEO*

Yes. Paul, I would say, first off, I can't make the correlation between the economy and storage being a lagging indicator. Ken (inaudible) who started this business for 33 years had never seen storage go negative and we're in the worst recession in nearly 80 years and we're just in uncharted territory and to try and tie correlative measures to our performance or vice versa, I can't do the math on that and I would just simply say we relatively speaking to think about the worst recession in 80 years and we're forecasting being down 4% plus or minus a percent, I think is a remarkable performance and I think the next few quarters will be more telling. In my earlier remarks, as I said, for nearly 18 months all of the storage operators, the public operators were in positive territory until Q1 and I think that that is remarkable and so I'm not ready to make that leap of logic and say it's a leading indicator.

Paul Adornato - *BMO Capital Markets - Analyst*

Okay. Thank you.

Spencer Kirk - *EXTRA SPACE STORAGE INC - Chairman & CEO*

Or a lagging indicator, rather.

Operator

Your next question comes from the line of Jeff Donnelly from Wells Fargo. Please proceed.

Jeff Donnelly - *Wells Fargo - Analyst*

Yes, just a few questions, actually, Spencer if I could kind of build on that and maybe an earlier comment, certainly I appreciate these are unprecedented times, but if I extrapolate one of your earlier responses, does that mean that we should think about the 5% decline in NOI in your guidance as the best case outcome for 2009 or is the 5% to 7% instead more representative -- I guess I will call it the range of outcome to the more conservative end of your expectations?

Spencer Kirk - *EXTRA SPACE STORAGE INC - Chairman & CEO*

A, more conservative and, B, it's the range.

Jeff Donnelly - *Wells Fargo - Analyst*

And then I'm curious, you know, are you able to share with us maybe what your guidance is for Q3 or at least how quarter to date in Q3 you're shaping us versus your full year guidance pace?

Spencer Kirk - *EXTRA SPACE STORAGE INC - Chairman & CEO*

Revenue top line, you know, we talked about one month and expenses we have nothing to comment on. It's too early.

Jeff Donnelly - *Wells Fargo - Analyst*

Okay. And then -- and I'm curious, a year ago people were fixated on, you know, whether or not there was a -- I guess I'll call it a foreclosure benefit, if you will, to be had out there and we saw the sort of cessation of activity at banks that has since resumed. Have you seen increased activity in markets where foreclosure activity has resumed that, you know, that may be spurring incremental demand or is it too hard to discern?

Spencer Kirk - *EXTRA SPACE STORAGE INC - Chairman & CEO*

There are -- we hear it ad hoc that happening, but I think in the markets where that's happening, I think there's other things going on. I mean southern California would be a -- a perfect example, especially you get to the east theres LA and there's incredible levels of foreclosure and even in south Florida, you know, Fort Myers and those areas and yet we're not really seeing any tremendous benefit from it and I think it very well could be that, you know, yes, you have some -- because we certainly do get some people that are being forced out of their house or whatever and they're renting units, but I think at the same time you have a lot of other people that are stressed that maybe are discretionary users that now they don't have any discretionary income.

Jeff Donnelly - *Wells Fargo - Analyst*

Right, and then just one last question, just to confirm something, the increase in your tenant reinsurance income in the guidance, is the expectation there just higher turnover in your tenant base that's driving that?

Kent Christiansen - *EXTRA SPACE STORAGE INC - CFO*

No. Our penetration just continues to grow because you know we started this two or three -- two and a half years ago, three years ago and we just had steady growth and we're not sure where exactly it's going to top out. Our goal this year was -- you know, we've already kind of hit our goal. We expected it to be somewhere in the range of about 52% and we're already at about 52.6%. So, we expect to continue to have a little bit of growth, but it really doesn't have anything to do with anything unusual with the rental or vacate trends.

Jeff Donnelly - *Wells Fargo - Analyst*

Okay. I was curious just because from your prior guidance, it's up, I think, about 15%, 20%. It just seemed like a marked move unless it was just you were initially much more conservative and became I'll call it more realistic as the year went on?

Kent Christiansen - *EXTRA SPACE STORAGE INC - CFO*

I think thats probably more the point.

Jeff Donnelly - *Wells Fargo - Analyst*

Okay, thanks, guys.

Kent Christiansen - *EXTRA SPACE STORAGE INC - CFO*

Thank you.

Operator

Your next question comes from the line of Ryan [Milaker] from Morgan Stanley. Please proceed.

Ryan Milaker - *Morgan Stanley - Analyst*

Good afternoon, guys. I just had a couple of quick questions. I was hoping you could talk me through a little bit how you think about rate versus occupancy. And specifically, you know, I know you guys have a more detailed revenue management system than a lot of your competitors. Do you have any idea where your rates are, you know, across the country relative to your competitors? You know, you mentioned that a lot of the private companies are starting to lower rates. Are you at a substantial discount, is that discount shrinking, what would spur you on to creating larger discounts or at what point do you start to push towards occupancy as opposed to rates? Thanks a lot.

Karl Haas - *EXTRA SPACE STORAGE INC - COO*

I'll start and maybe let Kent jump in here and Spencer. This is Karl. We have continued to be very aggressive on rates and at least based on the data we have on a global basis, we are slightly less than most of our competitors, although that gap is a little bit less now than, you know -- with maybe the exception of PSA who has -- who spikes rates in June and July. But we've continued to be very aggressive on rates and the good news is we've started to see some turn around in occupancy, which we now feel should give us some opportunities to start to turn the rates around. We really started dropping -- we really made a dramatic drop in our rates in February and we've pretty much held rates down since then and the first couple of months we didn't see much impact from it, but in the last three months, we have, you know, seen a steady decline in the square foot delta the prior year. Kent, you want to add anything?

Kent Christiansen - *EXTRA SPACE STORAGE INC - CFO*

No, I think that's good, Karl.

Ryan Milaker - *Morgan Stanley - Analyst*

So, when you say slightly less, are we talking 1%, 5%, 10% and how does that differ from at the end of March or in April after you guys reported the last time?

Kent Christiansen - *EXTRA SPACE STORAGE INC - CFO*

Ryan, we can tell you we're having a hard time hearing you. Could you speak up a little bit on the last part of your question there?

Ryan Milaker - *Morgan Stanley - Analyst*

I'm sorry. I'm trying to understand the variance in terms of how your rates have shifted relative to your competitors and I'm not talking necessarily specifically the public companies, but maybe you've got your five competitors in each given market so to speak, where are your rates relative to them and how has that changed over the past three months? You mentioned that they've come down, so when you say slightly less, are we talking 1%, 5%, 10%?

Spencer Kirk - *EXTRA SPACE STORAGE INC - Chairman & CEO*

Well, overall, you know, in April, we were about -- somewhere in the range of about 8% less than our competitors and in July we're about 7% less than our competitors.

Ryan Milaker - *Morgan Stanley - Analyst*

Wonderful. Thanks a lot.

Operator

Your next question is a follow-up from the line of Todd Thomas from KeyBanc Capital Markets. Please proceed.

Todd Thomas - *KeyBanc Capital Markets - Analyst*

Hello, it's Jordan here with Todd. Just -- I don't know if I missed this, do you have a measure of traffic during the quarter and maybe close ratios, Karl?

Karl Haas - *EXTRA SPACE STORAGE INC - COO*

Well, we do from our call center, which is a little bit distorted because, you know, the call center, you know, was gearing up in December and January, but, yeah, I mean our overall -- actually, our close rates have continued to increase at the call center. In March, they were -- March, April, they were in the mid-20 range and in June, we peaked at about 32% and it's a weighted average conversion rate.

Todd Thomas - *KeyBanc Capital Markets - Analyst*

Okay. And how would that compare versus last year, you think? Or -- oh, you don't have those?

Karl Haas - *EXTRA SPACE STORAGE INC - COO*

Unfortunately we don't have that comparison because our call center started in December. We'll have it -- if you call back a year from now, we'll have that for you.

Todd Thomas - *KeyBanc Capital Markets - Analyst*

Alright. Exactly one year from now? I'm --

Karl Haas - *EXTRA SPACE STORAGE INC - COO*

Give or take a few days.

Todd Thomas - *KeyBanc Capital Markets - Analyst*

I know.

Karl Haas - *EXTRA SPACE STORAGE INC - COO*

Sorry. We have what our other call center was doing, but it was just doing the overflow calls. So, we really -- we'd be telling you something we don't --

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Todd Thomas - *KeyBanc Capital Markets - Analyst*

What about traffic? Something on a relative basis --

Karl Haas - *EXTRA SPACE STORAGE INC - COO*

I think we have to base traffic -- tie it to, you know, rentals and rentals are slightly down.

Todd Thomas - *KeyBanc Capital Markets - Analyst*

Move ins, basically?

Karl Haas - *EXTRA SPACE STORAGE INC - COO*

Right.

Todd Thomas - *KeyBanc Capital Markets - Analyst*

And is that -- do you think that's correlated to the advertising reduction or -- I mean you don't seem -- you didn't seem impressed by television last year, yet is it coincidental that in this quarter your traffic appears to be -- as measured by -- I mean you talked about the demand probably being 5% to 10% down. We haven't seen the rest of your competitors reports yet, but do you think that maybe there's a correlation there, you're spending less on the advertising front, your traffic may be down and, therefore, your move ins or rentals are down? Or you're not sensing that?

Karl Haas - *EXTRA SPACE STORAGE INC - COO*

We don't -- we don't sense that and, you know, it's also a matter of the cost of it versus the benefit of it and we didn't -- you know, it very well can be that, you know, we could have spent the million dollars and it may have had some impact on our rentals, but -- but, you know, that's -- you know, it's more what we got from it and when we looked at the return on investment, we determined it was not a good investment.

Todd Thomas - *KeyBanc Capital Markets - Analyst*

Okay. And then just following up on one of your comments, Kent, as you were talking about deleveraging at these different levers to pull, one of which was, you said, equity and selling equity in the company, is there something -- is there an intention to sort of delever through maybe equity as opposed to asset sales?

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Spencer Kirk - *EXTRA SPACE STORAGE INC - Chairman & CEO*

Jordan, this is Spencer. I'd like to take that. A couple of observations. Number one, we are not comfortable on commenting on capital market considerations as just a matter of policy. I can tell you that all options are on the table, but for me personally as the single largest private shareholder, I am very sensitive to additional dilution and we're looking at all options, we think that as Kent pointed out earlier, there are more elegant ways to delever without impacting us and we'll have to analyze and dissect it and decide, but today, it's only an option.

Todd Thomas - *KeyBanc Capital Markets - Analyst*

How would you rank the options today in terms of attractiveness?

Spencer Kirk - *EXTRA SPACE STORAGE INC - Chairman & CEO*

It's an option.

Kent Christiansen - *EXTRA SPACE STORAGE INC - CFO*

It's more attractive at $17 a share.

Todd Thomas - *KeyBanc Capital Markets - Analyst*

No, no, no, I'm saying in terms of your options for delevering --

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Spencer Kirk - *EXTRA SPACE STORAGE INC - Chairman & CEO*

I'm not going to rank it, Jordan, I apologize, but just it's an option and today it's not at the top of the list. Let's leave it at that.

Todd Thomas - *KeyBanc Capital Markets - Analyst*

Okay. Thank you.

Operator

Your next question is a follow-up from the line of Michael Knott from Green Street Advisors. Please proceed.

Michael Knott - *Green Street Advisors - Analyst*

Remind us, I think you gave how the street rate compared to the in place rent at the end of the quarter. What was it a year ago? What was that comparison a year ago? I think you said $112 and $130 or --

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Kent Christiansen - *EXTRA SPACE STORAGE INC - CFO*

Like $126 and $133.

Michael Knott - *Green Street Advisors - Analyst*

Okay. And then Spencer, just a question for you. Longer term, as you think about the possibility of the shape of the economic recovery, potentially an L shape, maybe not a strong rebound, how do you think about the longer term viability of certain aspects of the need-based economy for self storage renters, i.e. you know, if we don't have a strong recovery in jobs, will there be fewer people relocating and maybe having fewer need-based demand drivers or maybe with lower consumption and lower junk -- lower amounts of junk to store? How do you think about how the economic recovery, whenever it comes, what it looks like, what impact that has on your business?

Spencer Kirk - *EXTRA SPACE STORAGE INC - Chairman & CEO*

Michael, I think one of the important points that I talked about earlier was that we had nearly 90,000 rentals in the quarter. The need-based element of this business has not evaporated. What seems to have changed is the price point that we're able to get and I think that as the economy turns and we get a little more advantage on pricing, we'll be the beneficiary of that. But for me, I have to tell you there are life changing events that happened in expanding markets and contracting markets and the data seems to suggest very strongly that that continues to be the case. And the economic upturn, whatever time that inflection point may take place is anybody's guess, but at whatever point that happens, I think that's where you see some pricing power coming in and us starting to deliver better results. So, that's kind of how I'm looking at the future. I want to be cautious about the near term, but as I said in my closing remarks, I am optimistic about the future and I am committed to the business and then looking forward to producing a solid return for the investors. And with that, I'd like to suggest that we wind this conference call to a close. We've appreciated your interest in Extra Space and we'll look forward to our next earnings call. Thank you.

Operator

Thank you for your participation in today's conference. This concludes the presentation. You may now disconnect. Good day.
