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EXR - Q1 2012 Extra Space Storage Inc. Earnings Conference Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the quarter one 2012 Extra Space Storage, Inc. earnings conference call. My name is Shanice and I'll be your operator for today. At this time, all participants are in listen-only mode. Later we will conduct a question-and-answer session.

(Operator Instructions)

As a reminder, this conference is being recorded. I would now like to turn the call over to your host for today, Mr. Clinton Halverson. Please proceed.

Clinton Halverson - *Extra Space Storage Inc - IR*

Great, thank you.

Welcome everyone to Extra Space Storage's first quarter 2012 conference call. In addition to our press release, we've furnished unaudited supplemental financial information on our website. In addition, the Company will also be sharing updates from the earnings call via Twitter. If you'd like to receive these updates, please follow Extra Space at www.twitter.com/extraspaceir.

Please remember that management's prepared remarks and answers to your questions may contain forward-looking statements as defined in the Private Securities Litigation Reform Act. Actual results could differ materially from those stated or implied by our forward-looking statements due to risks and uncertainties associated with the Company's business. These forward-looking statements are qualified by the cautionary statements contained in the Company's latest filings with the SEC, which we encourage our listeners to review. Forward-looking statements represent management's estimates as of today, Tuesday, May 1, 2012. The Company assumes no obligation to revise or update any forward-looking statements because of changing market conditions or other circumstances after the date of this conference call.

I would now like to turn the call over to Spencer Kirk, Chairman and Chief Executive Officer.

Spencer Kirk - *Extra Space Storage Inc - Chairman and CEO*

Thank you, Clint. Hello, everyone. We appreciate you joining with us today. Joining me are Karl Haas, our Chief Operating Officer, and Scott Stubbs, our Chief Financial Officer.

It was a really good quarter. Our entire team did an outstanding job of focusing on the fundamentals of our business. We achieved $0.33 per share of FFO which was at the top end of our estimate and represents a robust 32% increase over last year. Same-store revenue growth was up 6.3%. Expenses were down 1.7%, and NOI was up 10.8%. These results are impressive given last year's tough comparables which consisted of 4.2% revenue growth and 5.8% NOI growth.

While we are pleased with our performance, I want to set the proper expectation that this quarter's results are not the ongoing run rate for our operational performance. We anticipate a return of the same-store growth rate that is more in line with historical norms.

After the end of the quarter, we announced an agreement to buy our partner's interest in one of our joint ventures with Prudential for $298 million. We've been partners with Prudential since 1998. This deal represents a significant milestone where we were able to create value for Prudential and for Extra Space. It proves that our unique ownership and management structure provides with us an off-market conduit of acquisition opportunities with reduced transactional risk. This structure is one of a kind in the self-storage industry.

This transaction with Prudential underscores the value of relationship that have been nurtured for years. When the time came for Prudential to sell, there was one call and only one call. Simultaneously with the Prudential announcement, we successfully executed a secondary offering raising $227 million. As we have said in the past, when we can enhance shareholder value, we will tap the capital markets.

With that, let's turn the call over to Karl to discuss operations.

Karl Haas - *Extra Space Storage Inc - COO*

Thanks, Spencer.

2012 started out where 2001 (sic) finished, with another quarter of revenue growth and expense control. Same-store revenue was up 6.3%. Expenses were down 1.7% and NOI was up 10.8%. Our same-store results were aided by the addition of 29 stores that entered the same-store pool in 2012. Our same-store definition, which has been in place since going public in 2004, consists of properties that have been opened for more than 3 years as of the beginning of the year or have an average occupancy of over 80% for the prior calendar year. Our new pool of 282 property includes 19 sites that are over 3 years old and are in the final stages of lease up. As a result, we received almost 100 bips of top line benefit from the change in the same-store pool. By stripping these 19 properties out, our top line revenue growth would have been 5.3%.

Expenses were down 1.7% primarily due to slow snow removal and utility costs as a result of a mild winter. While we continue to implement processes and investment systems that create efficiencies, we don't expect our expense rate growth rate to continue at Q1 levels. Expenses will return to a more normal level as we move through the year.

Our occupancy remains historically high going into the rental season which is a positive sign for the potential for continued regrowth. Reduction and discounts and promotions also aided Q1 revenue growth and bodes well for the remainder of year as long as demand in occupancy holds. For the quarter, discounts were down approximately 5% compared to 2011 and we saw an average increase in street rates of over 3.5% compared to last year. Our revenue growth for this quarter was extremely close to what we had budgeted. Our occupancy is at historical levels. We are pushing rates and we feel good about the remainder of the year.

With that, I'd like to turn it over to Scott.

Scott Stubbs - *Extra Space Storage Inc - CFO*

Thanks, Karl.

Last night, we reported first quarter FFO of $0.33 per share, including $0.01 of lease-up dilution. Our results were at the top end of our guidance, primarily due to lower operating expenses at the properties. During the quarter, we incurred approximately $0.01 of additional interest expense associated with the accelerated write- off of closing costs associated with the prepayment of certain loans. In light of the low interest rate environment, we continue to prepay loans. This is a long-term strategic decision where we have replaced higher interest rates with lower interest rates. The additional interest expense that we're incurring in the short term to refinance these loans will be more than offset in the long term as we reap the benefit of lower interest rates.

During the quarter, we closed on two acquisitions located in Maryland and Texas for approximately $16 million. In addition, we opened our final development project in Northern California. All three of these properties are excellent additions to our portfolio.

Subsequent to the end of the quarter, we entered into an agreement with Prudential to acquire its interest in one of our joint ventures for $298 million. The purchase price consists of $160 million of cash and the assumptions of an existing loan of $145, of which $138 million relates to Prudential's interest. The 36 properties are located in 18 states and mirror our overall portfolio quality. Having operated the properties for nearly 7 years, we feel comfortable with the purchase price and future performance estimates. We expect to finalize this transaction in July based on customary closing conditions. Including the properties we are purchasing from the Prudential joint venture, we currently have 42 properties under contract for a total purchase price of approximately $333 million. These properties are scheduled to close throughout the year.

Subsequent to the end of the quarter, we sold 8 million shares of common stock at $28.22 per share for net proceeds of approximately $227 million. We will use the money from this offering to fund the acquisition of Prudential's interests in the joint venture, other acquisitions, to pay down debt, and for other corporate purposes.

Taking into account the pending acquisitions, the equity offering, and our operational performance to date, we are adjusting our full-year 2012 FFO guidance to be between $1.40 and $1.46 per share. We expect to earn between $0.33 and $0.35 of FFO in the second quarter. Key assumptions relating to these estimates can be found in our press release.

With that I'll turn the time back over to Spencer for closing remarks.

Spencer Kirk - *Extra Space Storage Inc - Chairman and CEO*

Thanks, Scott.

Just six weeks ago, I stated that Extra Space had one main theme as we entered 2012, focus on fundamentals. We executed well in Q1, and we are in a good position to put up solid results for the rest of the year. I'd now like to turn the time over to Clint to start the question-and-answer session.

Clinton Halverson - *Extra Space Storage Inc - IR*

Thanks, Spence. In order to ensure we have adequate time to address everyone's questions, I would ask that everyone keep your initial questions brief and, if possible, limited to two. If time allows, we will address follow-on questions once everyone has had an opportunity to ask their initial question. With that, we will turn it over to Shanice to start our questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first line of questioning comes from Swaroop Yalla of Morgan Stanley. Please proceed.

Swaroop Yalla - *Morgan Stanley - Analyst*

Yes, hi, good morning. Karl, this is in regards to the same-store pool change. I noticed that the change in occupancy due to the same-store pool was 170 basis points. You mentioned about 100 basis points. So I wanted to find out what that difference is.

Second, in your same-store guidance, I'm just assuming that this 100 basis points rolls through, so if we should be thinking about what level of occupancy gains are anticipated in the guidance.

Karl Haas - *Extra Space Storage Inc - COO*

I think you misunderstood me. I was talking about same-store revenue growth, not occupancy growth. And those numbers are built in to our numbers for the rest of the year. It wasn't about occupancy. I think we reported 6.3% revenue growth. And without those properties in the pool, it would have been 5.3% revenue growth.

Swaroop Yalla - *Morgan Stanley - Analyst*

Oh, I see. So there was the 170 basis point change in the occupancy, but maybe the rents were offsetting that slightly?

Scott Stubbs - *Extra Space Storage Inc - CFO*

Swaroop, this is Scott. It's a little bit skewed because if you take the year-end occupancy for the 253 and then go to the quarter-end occupancy for the 282, it causes a bit of an adjustment there. So you are right. The period-over-period, it does look like it changed more than it did.

Swaroop Yalla - *Morgan Stanley - Analyst*

Got it. That's -- I can talk to you off line about this.

Turning to the acquisition, just wanted to find out a little bit about what sort of acquisition costs are involved in this Prudential JV. You raised guidance for the acquisition costs and as well as volume. So I just wanted to find out about the acquisition costs.

Scott Stubbs - *Extra Space Storage Inc - CFO*

Great. This is Scott. The majority of the closing cost associated with the Prudential acquisition primarily relate to transfer or mansion taxes which the Company will have to pay. Closing costs are going to be following tradition as far as who pays those, but there will be some of those that will be incurred by the Company.

Swaroop Yalla - *Morgan Stanley - Analyst*

And we should be thinking about, in terms of acquisition volume, can you give us guidance on what does that acquisition cost?

Scott Stubbs - *Extra Space Storage Inc - CFO*

The acquisition costs relating to the Prudential acquisition are going to be, call it, $1.5 million and then you've got another $1 million relating to the $100 million worth of acquisitions and that's effectively the $2.5 million to $2.7 million for the year.

Swaroop Yalla - *Morgan Stanley - Analyst*

All right, thank you.

Operator

Your next line of questioning comes from Michael Knott, Green Street Advisors. Please proceed.

Michael Knott - *Green Street Advisors - Analyst*

Hey, guys. Just wanted to ask on that same-store question again. The year-over-year occupancy gap was 340 basis points, which I think looked like a 30 basis points gain from the fourth quarter, again year-over-year. What would that number have been with the same pool as the fourth quarter of '11?

Karl Haas - *Extra Space Storage Inc - COO*

Michael, your point is correct in that the occupancy looks like it went up as a result of the change in the same-store pool. We don't have that right here in front of us. But it would probably be more like about 2.5, something like that.

Michael Knott - *Green Street Advisors - Analyst*

So the year-over-year occupancy gap probably shrunk a little bit, as you had expected if the pool had been similar as to --.

Karl Haas - *Extra Space Storage Inc - COO*

Yes, yes. We have reached our occupancy goal as we've said probably in the last couple, especially the last call. And that gap will continue to close until probably the middle of the year, will be close to zero, as far as the square foot delta.

Spencer Kirk - *Extra Space Storage Inc - Chairman and CEO*

Right, okay. And then, a question for Spencer and Scott. Sort of a recent development I guess that's different from how it's been in the past is unsecured debt is now cheaper than secured debt, or so it seems for the most part for real estate. Does that make you more interested in eventually adding that to your financing menu?

Scott Stubbs - *Extra Space Storage Inc - CFO*

Yes. Michael, this is Scott. As we've mentioned in the past, all things are on the table. We're looking at all of our options. We're able to get secured debt quite -- it's pretty inexpensive right now, 5 years are 3.3%, 3.4%, then 8 years, going as high as 3.75% to 3.85%. So, it's something we're looking at but it's not really a change in strategy for us.

Michael Knott - *Green Street Advisors - Analyst*

Okay. Thanks.

Operator

Your next line of questioning comes from Michael Salinsky, RBC Capital Markets. Please proceed.

Michael Salinsky - *RBC Capital Markets - Analyst*

Good afternoon. Scott, first question for you. You talked about additional refinancing you guys are looking at for 2012 in addition to the charges you recorded in the first quarter. Is there additional charges based on refinancings and how much do you expect to refinance pulling forward there, embedded in your guidance there for 2012?

Scott Stubbs - *Extra Space Storage Inc - CFO*

Just to make sure I understand your question, you're talking about early additional prepayments or just normal refinancing, for instance, in regard to the Prudential transaction?

Michael Salinsky - *RBC Capital Markets - Analyst*

No. You talked about taking down some of your longer dated maturities, given the current spread there between in place and where you can refinish today. And you said you had a charge in the quarter so I was asking how much do you plan to pull forward, in terms of refinancings?

Scott Stubbs - *Extra Space Storage Inc - CFO*

In our guidance right now, we have about another $800,000 to $1 million that we expect to incur this year of additional interest expenses, associated either with prepayment penalties, or early payoffs, or writing off the loan fees associated with early prepayment.

Michael Salinsky - *RBC Capital Markets - Analyst*

Do you have the dollar amount of the loans?

Scott Stubbs - *Extra Space Storage Inc - CFO*

It is -- this year we will have paid off around $80 million between first, second, and into July of this year.

Michael Salinsky - *RBC Capital Markets - Analyst*

That $80 million is pulled forward, or is that the normal maturities?

Scott Stubbs - *Extra Space Storage Inc - CFO*

No, that's pulled forward. Those are prepayments.

Michael Salinsky - *RBC Capital Markets - Analyst*

That's helpful. Second of all, Karl, in your prepared remarks, you talked about street rates and I think you quoted 2.5% in the quarter. Can you give us a sense of how those are trending in April? And also as we saw vacates pick up, where is the delta right now between in place and street rates, just knowing how aggressive you --

Karl Haas - *Extra Space Storage Inc - COO*

It was 3.5%, not 2.5%. If I said 2.5%, that's an error. It's about 3.5% and that's holding in April. We're hoping that that's going to hold. We're hoping in that 3% to 4.5% rate area that we'll be able to keep street rates above the prior year. The gap between the street rate and the existing customers is almost nil. We do a graph of it and the lines have merged.

Michael Salinsky - *RBC Capital Markets - Analyst*

Okay, that's encouraging. Then, just a final question. Can you talk a little bit in terms of asset pricing and also in terms of deal volume? Seems like the pipeline picked up in addition to the joint venture there. Just curious as to what you're seeing there.

Spencer Kirk - *Extra Space Storage Inc - Chairman and CEO*

Michael, it's Spencer. Deal volume, there is a fair amount of activity out there. There's also a lot of interest in self-storage and there is a lot of competition for these assets. And I would say there, of course, is still the uncertainty as to what's going to happen at the end of the year with the tax environment. Going forward, I would say that there's not been a dramatic tick up for us. We have seen some activity. We stand behind the guidance that we've given and we'll see how the rest of the year transpires.

Michael Salinsky - *RBC Capital Markets - Analyst*

Great. Thank you much.

Spencer Kirk - *Extra Space Storage Inc - Chairman and CEO*

Thank you, Michael.

Operator

Your next line of questioning comes from Eric Wolfe of Citi. Please proceed.

Eric Wolfe - *Citi - Analyst*

Thanks. Just want to follow up on Mike's question there. You only have another, I guess, about $50 million in guidance in terms of acquisitions. I guess my question is, can you see yourself maybe doing a couple hundred million more this year? Because it feels like with your cost of capital right now and everything going so well, it feels like you're going to exceed your acquisition guidance.

Spencer Kirk - *Extra Space Storage Inc - Chairman and CEO*

On this, Eric, it's entirely possible. But given where we sit today, I am not aware of any other large transaction that is several hundred million dollars sitting out there. It could be, but $50 million, $100 million, yes, we might do a little better. But I would not expect something in the order of a magnitude of something we just announced with Prudential where you're at $300 million. We don't have anything on the radar screen today.

Eric Wolfe - *Citi - Analyst*

Got you. For the Prudential acquisition, how would you say that the pricing lined up relative to everything else you're seeing in the market? Just using math on it, it looks to be mid-6% implied cap rate. Obviously, you're losing management fee. But just wanted to get your sense on why you think that's a good return in acquisition relative to your cost of capital.

Scott Stubbs - *Extra Space Storage Inc - CFO*

This is Scott. One of the things that we agreed to with Prudential was not to discuss cap rates so contractually we're not going to get into specifics on that. What we would tell you is that it's not that different than what we've been buying. We continue to find things that accretive to the shareholders and help increase the FFO. We felt like it was a good transaction. It's accretive, especially with the cost of leverage, putting debt on it right now so I think that obviously the numbers are out there. You're able to calculate things. But based on contractual obligations with Prudential, we'd rather not get into the specifics.

Eric Wolfe - *Citi - Analyst*

Okay.

Spencer Kirk - *Extra Space Storage Inc - Chairman and CEO*

Another piece to that, too, is that with the Prudential acquisition, we already have them signed. They're already signed. They're already imaged as Extra Space stores. And we really have such deep in-depth knowledge of the properties that from a risk standpoint, we really have a lot less risk than buying somebody else's properties.

Eric Wolfe - *Citi - Analyst*

Understood. And a real quick one. Did you earn a promote on the fund, just given the 12% hurdle?

Scott Stubbs - *Extra Space Storage Inc - CFO*

We are actually buying Prudential's joint venture interest so we will not necessarily be receiving a promote in this deal. We're just buying the partnership interest.

Eric Wolfe - *Citi - Analyst*

Got you. Thank you.

Spencer Kirk - *Extra Space Storage Inc - Chairman and CEO*

Thank, Eric.

Operator

Your next line of questioning comes from Todd Thomas, KeyBanc Capital Markets. Please proceed.

Todd Thomas - *KeyBanc Capital Markets - Analyst*

Hi, good afternoon. I'm on with Jordan Sadler as well.

Spencer Kirk - *Extra Space Storage Inc - Chairman and CEO*

Hi.

Todd Thomas - *KeyBanc Capital Markets - Analyst*

Hi. Just a question on occupancy as it pertains to guidance. I think last quarter you'd indicated that average occupancy of about 87% was embedded in guidance for the full year and average occupancy this quarter was 86.8%. I think historically, occupancy's risen about 350 basis points from first quarter to third quarter. That would put you well on track to be above 90%. Are you guiding to a higher occupancy level throughout the year at this point?

Karl Haas - *Extra Space Storage Inc - COO*

No. This is Karl. No, we're really still on the same program. However, our system, our revenue management system is really not as directly driven by occupancy that we've rolled in to a new version of our revenue management system. The prior system was totally driven by the occupancy number. So, it was very clear cut. We were going to get to that 87%, that goal occupancy. Our system that we're running right now, while we're still using 87%, that mid-high 80s as our goal occupancy, the system is really also factoring in a whole lot of other things and trying to maximize revenue. So it's possible we might average a little bit higher than that number. But there really isn't something, it's not driven. We have not made a conscious decision to change our occupancy goal.

Spencer Kirk - *Extra Space Storage Inc - Chairman and CEO*

Yes, Tom, Jordan, this is Spencer. As you see us progressing through the year, you'll probably notice that the occupancy delta is going to start to come down and approach zero toward the end of the year. Because once again, we're not about maximizing occupancy or maximizing price. We're about maximizing revenue and that's the system that Karl has alluded to. It's our third generation revenue management system and we think that it's delivering the intended result.

Todd Thomas - *KeyBanc Capital Markets - Analyst*

Okay. That's helpful. And then just switching over. Second question, on acquisitions. Just curious about your thought process. Given the opportunity to buy some higher quality assets, if the opportunity was to arise, would you be willing to endure near-term dilution? And also, would you be willing to buy high-quality assets at a comparable initial yield to where your implied cap rate is today?

Spencer Kirk - *Extra Space Storage Inc - Chairman and CEO*

I would just say that's one that we would have to really take a close look. We've got a nice, high-quality portfolio. We don't need a transformational transaction to redefine who and what we are. What we do need is to have accretive deals that enhance shareholder value. And you talked about near-term dilution. I'd have to understand the fact and circumstance and the operational overlay and a lot of other things. But clearly this management team has tried to be wise in the acquisitions and make sure that they add value operationally, as well as financially and to that end, it's on a case-by-case basis.

Todd Thomas - *KeyBanc Capital Markets - Analyst*

Okay. Thank you.

Operator

(Operator Instructions) Your next line of questioning comes from Ki Bin Kim of Macquarie. Please proceed.

Ki Bin Kim - *Macquarie Research Equities - Analyst*

Thank you. It looks like this quarter your vacancies picked up quite a bit. I was wondering if you could provide color on that. And how much of that was almost directly related to sending out rent increase letters that drove customers out?

Karl Haas - *Extra Space Storage Inc - COO*

This is Karl. Almost none. We constantly monitor our rate increases. We call them ECRI, existing customer rate increases, and it's not a driver of significant vacancies. Vacancies is something we really have found, I think, anybody else in our industry would tell you the same thing, we really don't have much control over. I think the one thing that is catching up a little bit is that we had lower-than-normal vacancies last year. So this is probably bringing us probably a little bit closer to a more normal level of vacancies.

Ki Bin Kim - *Macquarie Research Equities - Analyst*

And second question. It looks like you lost a couple of properties in the third-party management business. Did I capture that correctly? Or -- I was wondering if you could provide a little more detail around that.

Karl Haas - *Extra Space Storage Inc - COO*

You did. We added seven and lost nine. Six of the properties were sold by a company out of Australia that was in liquidation that has been divesting of those properties over a two-year period.

Ki Bin Kim - *Macquarie Research Equities - Analyst*

Okay. Thank you.

Operator

Your next line of questioning comes from Eric Wolfe, Citi. Please proceed.

Michael Bilerman - *Citi - Analyst*

It's Michael Bilerman speaking with Eric. I just wanted to come back to buying out Prudential and I think you mentioned that you bought the partnership interests which is why it didn't trigger the promote, which would have reduced your basis. It would seem that at the pricing that you've contracted at, that if it would have gone to a third party, this would have generated an IRR in the high teens. And based on you getting 20% of the excess above a 12, this could've resulted back of the envelope on our math of $6 million which would have reduced your purchase price even further.

So I'm just trying to understand. Spence, you said Prudential made one call and the only call they made was to you. I guess as you evaluated your opportunities in the negotiation, how much time do you spend of saying, look, if we took this out to another capital source that would want us to operate it because we know these assets well and we operate them well, not only would we keep the lucrative management fees and keep our ownership and you could've taken ownership up from 5% to 25% if you wanted, but we would generate another $5 million, $6 million of capital for our shareholders?

Spencer Kirk - *Extra Space Storage Inc - Chairman and CEO*

Yes. The answer on that, Mike, was this. This management team is trying to build the REIT and 100% wholly owned I think is going to provide the most juice in FFO and core growth on everything that we're doing. I'd rather own 100% of the assets than own a piece, but our structure is such that we have the flexibility of having three types of buckets into which categorize assets, wholly owned, partially owned, or non-owned. We think that the two latter categories provide a nice acquisition pipeline that when the time comes and our partners want to monetize their assets, we're very happy to accommodate them with a wholly owned transaction. Because I think, once again, that's going to provide the most juice rather than a one-time gain that would've come through a promote.

Michael Bilerman - *Citi - Analyst*

But your promote would have been deduct from your purchase price if you bought if from Prudential. So I'm just curious why wasn't that part of the transaction? You gave Prudential a very high teens and maybe even more --

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Spencer Kirk - *Extra Space Storage Inc - Chairman and CEO*

Let's have Scott walk you through the math on this, Michael.

Scott Stubbs - *Extra Space Storage Inc - CFO*

Effectively, it was deducted from the amount we're paying Prudential. If you just take $298 million and divide it by 95%, you come up with the purchase price that's different in the purchase and sale agreement. So you can see clearly there was a waterfall. It is deducted from what we're paying out to Prudential.

Michael Bilerman - *Citi - Analyst*

Oh, it is, okay. So you effectively did get the benefit of the promote.

Scott Stubbs - *Extra Space Storage Inc - CFO*

We got the benefit of it. We paid them less, effectively.

Michael Bilerman - *Citi - Analyst*

Right. That's what I wanted to get toward. It almost sounded from your original answer that you gave that up, which I found --

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Scott Stubbs - *Extra Space Storage Inc - CFO*

Oh, no. We didn't give that up.

Michael Bilerman - *Citi - Analyst*

Okay. And was that amount $5 million or $6 million?

Scott Stubbs - *Extra Space Storage Inc - CFO*

We haven't put it out publicly but you can get pretty close just by the math of 95.5% and purchase price in the agreement of $322 million. Okay. Out of all, you still have a multitude of different ventures obviously dating back to the Storage USA acquisition. What's Prudential's desire to liquidate further? What prompted this joint venture relative to the other joint ventures? And how should we think about the opportunity that's left with these assets given, Spence, your comment that you would rather wholly own assets?

Spencer Kirk - *Extra Space Storage Inc - Chairman and CEO*

What I would say is I'm not going to speak for Prudential. We have several different funds that have invested in the various assets that we have in the joint venture relationship with Prudential. The various funds have different objectives. And depending on what that portfolio manager wants to achieve, given a certain timeframe or return hurdle or objective, we expect as has been in the past, there will be opportunistic times for us. If I could just remind everybody, just a few years ago, we significantly increased our stake in the Virginia Retirement System portfolio, VRS portfolio, because the fund manager wanted to capture some gains.

I don't know what the timeline internally is for each of the fund managers, in terms of exiting from what we hold in the joint venture relationship. But what I can tell you is we have an excellent relationship with Pru. We've nurtured it. We've cultivated it. It goes back to 1998. And I think that as time marches on, this is our core business. We are in storage in perpetuity. Prudential is investing in all sorts of different types of real estate products and classes and for us, we just expect if we maintain a healthy relationship, when they make the decision, we'll get the call. And we'll hopefully be able to transact in a fashion that adds value for our shareholders and is beneficial for the Prudential investors as well.

Michael Bilerman - *Citi - Analyst*

Okay. Thank you.

Spencer Kirk - *Extra Space Storage Inc - Chairman and CEO*

Thanks.

Operator

Your next line of questioning comes from Smedes Rose, KBW. Please proceed.

Smedes Rose - *KBW - Analyst*

Hi, thanks. Most are asked and answered but I was wondered if you could just comment in general about the acquisition environment and what sort of cap rates you're seeing? And has there been any substantial movement, generally over the past year, over the past several months?

Scott Stubbs - *Extra Space Storage Inc - CFO*

This is Scott, Smedes. We have seen pricing tick down a little bit. I think that you've got a lot of buyers out there. A lot of people chasing the yield. What used to trade at an 8% cap is now 6.5% to 7.5% and so over the last year, year and a half, you've definitely seen things tick down as far as cap rates.

Smedes Rose - *KBW - Analyst*

And when banks are underwriting loans, are they still using a 7% cap rate, or have they also moved that down? I think in the past you've said they used around a 7%.

Scott Stubbs - *Extra Space Storage Inc - CFO*

They're usually using actually a higher cap rate than a 7%. And it's all going to be adjusted in the loan-to-value. If they used a lower cap rate, they might not be as aggressive in the loan-to-value.

Smedes Rose - *KBW - Analyst*

Okay, thanks.

Spencer Kirk - *Extra Space Storage Inc - Chairman and CEO*

Thanks, Smedes.

Operator

Your next line of questioning coming from Ross Nussbaum, UBS. Please proceed.

Ross Nussbaum - *UBS - Analyst*

Hi, guys. Here with Christy. When you track reasons that your tenants are moving out, are you noticing any changes in trends in that behavior, over the last couple of months?

Karl Haas - *Extra Space Storage Inc - COO*

This is Karl. No.

Ross Nussbaum - *UBS - Analyst*

Nothing at all? There's no up tick at all in, the rent is too high, or increases in move-out because somebody was renting and now they're buying a home? Nothing?

Karl Haas - *Extra Space Storage Inc - COO*

No, we really have not seen any kind of change. And we do survey people.

Ross Nussbaum - *UBS - Analyst*

I would imagine that you guys have been pleasantly surprised by the revenue growth that's been produced, maybe not just by the Company, but by the industry over the last year. And as you look forward, it seems to me that the revenue growth that's been generated has been generated in a pretty lousy economy. As we go forward, part of me starts sitting here saying, I wonder what the demand's going to look like when you actually get people moving around to buy homes again. How much of an uplift do you think that's going to cause in industry demand for self-storage, if and when that picks up?

Spencer Kirk - *Extra Space Storage Inc - Chairman and CEO*

Ross, it's Spencer. Obviously, we're pleased. One of the theses that's been put out is that the larger operators, i.e. the public companies with their platforms and footprint have been able to take market share from the smaller operators. I firmly believe that that's the case and why the public companies have produced better results than the industry as a whole has been reporting.

We like storage for a variety of reasons. It does well in good economies and bad economies. And one of the things that you talked about is the uptick with an economy that might actually get on some firm footing and actually see some velocity in people's coming and goings, because moving is still the largest segment of drivers for our demand. And so for us, Ross, I don't know how to quantify it. But what I can say is we are optimistic about the future. We don't want to get ahead of ourselves. The economy is not great, but we do think that with an improving economy, there certainly is upside for storage and we're ready to participate to the fullest extent in that.

Ross Nussbaum - *UBS - Analyst*

Last question from me. Are you tracking the average household income or average income of your renter and maybe how that compares to where it was 5 or 10 years ago?

Spencer Kirk - *Extra Space Storage Inc - Chairman and CEO*

I can't answer with concrete data. What I can say is, we still think that within a 3-mile ring we still think that Extra Space has the highest median household income and greatest population density of any of the 4 public companies in the storage sector.

Ross Nussbaum - *UBS - Analyst*

Thanks.

Spencer Kirk - *Extra Space Storage Inc - Chairman and CEO*

Thanks.

Operator

Your next line of questioning comes from RJ Milligan, Raymond James. Please proceed.

RJ Milligan - *Raymond James - Analyst*

Hey, guys. I was wondering if you just could walk me through, how you get to the low end, or how you could get to the low end, of your same-store NOI guidance for this year. What would have to happen on the revenue side or the expense side for you to get that negative 4% -- I'm sorry, the positive 4%?

Scott Stubbs - *Extra Space Storage Inc - CFO*

From the revenue perspective, we've given guidance of 3.5% to 5%. Right now, we're coming in near our budget. And in order to hit the low end, obviously, you'd be falling below our budget. So if you think about this sequentially by quarter, you're at 6% today, and each quarter is going to tick down some in order to hit the 5% range. Things would have to get obviously worse towards the end of the year, but we are coming up against some pretty tough comps. And not knowing where the economy was going, we felt like it was probably better to be prudent in our guidance as far as keeping it where it was, from a revenue perspective.

RJ Milligan - *Raymond James - Analyst*

And so from a revenue perspective, would that be more move-outs or the inability, or fewer rental rate increases?

Scott Stubbs - *Extra Space Storage Inc - CFO*

In self-storage, one of the things that you find is, in order to get really strong revenue growth, you need to have pricing power. Your street rates, you need to have the ability to raise your street rates significantly. Right now with our street rates being 3.5% above where they were last year, clearly that's good and it's a good thing for the Company. But they're not 6%, 7% above where they were last year. So we're hitting our budgets and we're moving forward with this.

RJ Milligan - *Raymond James - Analyst*

And then on the expense side, what would need to happen for you guys to hit the high end of the expense growth expectations?

Scott Stubbs - *Extra Space Storage Inc - CFO*

Your biggest factor is going to be property tax reassessments and right now, we've budgeted just over 3% in property taxes. If some of those assessments come in at higher rates than we're anticipating, clearly it's going to affect your expenses to the rate where you come in at the higher end of your expense growth.

RJ Milligan - *Raymond James - Analyst*

Okay, great. Thank you, guys.

Spencer Kirk - *Extra Space Storage Inc - Chairman and CEO*

Thanks, RJ.

Operator

Your next line of questioning comes from Paula Poskon, Robert W. Baird. Please proceed.

Paula Poskon - *Robert W. Baird and Company - Analyst*

Thanks, good afternoon, everyone.

Spencer Kirk - *Extra Space Storage Inc - Chairman and CEO*

Hi, Paula.

Paula Poskon - *Robert W. Baird and Company - Analyst*

Two guidance line item questions for Scott. The G&A dollars came down. What's driving that?

Scott Stubbs - *Extra Space Storage Inc - CFO*

Mainly, we're running below our budget right now as far as the timing of some of our hires. And then our non cash compensation has been slightly below where we originally estimated.

Paula Poskon - *Robert W. Baird and Company - Analyst*

And likewise on the weighted average share count, just given the impact of the equity offering and where your weighted average is for the year implies some further share issuance. Is it safe to assume that would be more on OP units around the remaining acquisition volume?

Scott Stubbs - *Extra Space Storage Inc - CFO*

The only two change that really happened there were, one, obviously the equity offering and then, two, is with the exchangeable bonds that we just paid off. We ended up giving out more shares in regards to the piece that was in the money than we originally projected. At the end of the year, our stock price was lower than where it is today and where those actually converted at. So we ended up converting -- we ended up having to give more shares in that exchangeable.

Paula Poskon - *Robert W. Baird and Company - Analyst*

That's helpful, thank you, Scott. And Karl, are you seeing any vestige of new supply anywhere in your markets?

Karl Haas - *Extra Space Storage Inc - COO*

Very little. I mean, there are properties being built. We run into them. We just had one in New York that I saw. And we've seen them, bits and pieces here but nothing really dramatic. Based on coming out of, basically the second year coming out of a recession, you would've normally seen a whole lot more supply coming on than we're seeing. But very, very little.

Paula Poskon - *Robert W. Baird and Company - Analyst*

And do you think that's a function of still-constricted construction lending? Or do you think it's a function of developers, just don't have the stomach for the risk anymore?

Karl Haas - *Extra Space Storage Inc - COO*

I think it's totally bank related and lending related. I think that occupancies are up and rates are recovering. I think people still view our business as a very attractive business. But lucky for us and lucky for me, they just can't get loans.

Paula Poskon - *Robert W. Baird and Company - Analyst*

Thanks. And what do you think the opportunity set is in your existing portfolio for expansion opportunities?

Karl Haas - *Extra Space Storage Inc - COO*

Nothing dramatic. We've got -- I don't know -- 5 properties that we're currently working on that we've got some land that we can do expansions on and we're working on. Most of them are pretty modest. Our focus right now is more on starting a process -- and maybe I'll let Spencer talk about it -- we've got a lot of properties that are 15 to 20 years old that 15 to 20 years from now, may not look that great.

Spencer Kirk - *Extra Space Storage Inc - Chairman and CEO*

Yes. Paula, it's Spencer. What Karl's referring to is an internal initiative that we're just embarking on to make sure that our product remains relevant in the market in which we're doing business. We might have an asset today that's in good repair, good condition, well-located, but it's 30 years of age. And 15 years from now, it's going to be a pretty old asset and you can only continue to improve the physical asset of something so long before it becomes obsolete. So then you have to say how do we keep this product relevant in a market that obviously over the next 15 years will see some new competition come in.

And that's what Karl's talking about. We've got some projects we've looked at. We've got a much more expansive and comprehensive program to look at what makes economic sense. The challenge in self-storage is you've got a nice cash-flowing asset that's 88% occupied and you decide you want to knock down half of it to build a climate-controlled facility. Well, you can't pre-lease the space in the new building. You're going to go through the same protracted lease-up period on the new space as you would have on any new development. And economically you've got to be wise so that you don't make an aesthetic improvement to an economic detriment.

So we're going to take a close look at it and we're going to see what happens. And if it becomes material, we'll certainly be talking about it. But relevancy of the product in the market is what we're focused on.

Karl Haas - *Extra Space Storage Inc - COO*

Paula, now you see why I let Spencer answer it.

Paula Poskon - *Robert W. Baird and Company - Analyst*

Spencer, does that imply that we could see maybe a little more recycling of capital in the next couple of years?

Spencer Kirk - *Extra Space Storage Inc - Chairman and CEO*

Maybe. Once again, we're not prepared to make any announcement of something that's substantive to that end. We just want to make sure that we're focused on fundamentals in 2012 in producing the best result without neglecting the future and I think this team is doing a great job of the here and now and today, with an eye on the future.

Paula Poskon - *Robert W. Baird and Company - Analyst*

Fair enough. One last question. Any further clarity on Ken Woolley's return?

Spencer Kirk - *Extra Space Storage Inc - Chairman and CEO*

Our friend Ken Woolley, as you know, will be coming back as Executive Chairman and Chief Investment Officer, and we expect that to take place in Q3. Ken's got a lot of talent and a lot to add and we look forward to his contribution.

Paula Poskon - *Robert W. Baird and Company - Analyst*

That's all I have. Thank you, guys.

Spencer Kirk - *Extra Space Storage Inc - Chairman and CEO*

Thanks.

Operator

(Operator Instructions) Your next line of questioning comes fro Todd Stender, Wells Fargo Securities. Please proceed.

Todd Stender - *Wells Fargo Securities - Analyst*

Hi, guys. Thanks. Just to get a feel for how new supply might be greeted in the market. If you were to look at your Los Gatos project and really where we are in the cycle, what's your timeframe for that property to be at a stabilized occupancy? And how does that compare to what you originally thought when you broke ground in 2010?

Karl Haas - *Extra Space Storage Inc - COO*

Probably around 3 years, and that's actually for that property, it's pretty close to what we projected. I will say though that a lot of the properties that we opened in 2006, 2007 have taken substantially longer than that. There's been so little new product out there that's come along that I think the run-up of some of the new stuff, especially the quality of Los Gatos, are going to show a quicker rent-off.

Todd Stender - *Wells Fargo Securities - Analyst*

Okay, thanks. I think you indicated in your opening remarks, discounts were down 5% across the portfolio. Just breaking out some of the MSAs, what are markets that are still towards the high end? Is it still the markets we'd think of, like Phoenix and Las Vegas?

Karl Haas - *Extra Space Storage Inc - COO*

When you're saying high end on discounting?

Todd Stender - *Wells Fargo Securities - Analyst*

Yes.

Karl Haas - *Extra Space Storage Inc - COO*

Yes, because they're probably some of our lowest occupy.

Todd Stender - *Wells Fargo Securities - Analyst*

And what types of discounts are you still seeing, if you can quantify it some?

Karl Haas - *Extra Space Storage Inc - COO*

Well, as far as percentage of revenue?

Todd Stender - *Wells Fargo Securities - Analyst*

Yes.

Karl Haas - *Extra Space Storage Inc - COO*

Overall, it's around 5% and in those markets it might be probably 6%, or 7%, or 8% in cases.

Todd Stender - *Wells Fargo Securities - Analyst*

Okay. Thank you.

Spencer Kirk - *Extra Space Storage Inc - Chairman and CEO*

Thanks, Todd.

Operator

There are no further questions at this time. I would like to now turn the call back over to Spencer for closing remarks.

Spencer Kirk - *Extra Space Storage Inc - Chairman and CEO*

We appreciate your interest in Extra Space. Thanks for joining with us and we'll look forward to next quarter's call. Have a good day.
