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EXR - Q4 2014 Extra Space Storage Inc Earnings Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Q4 2014 Extra Space Storage Inc earnings conference call. My name is Mark and I'll be your Operator for today.

(Operator Instructions)

As a reminder this conference is being recorded for replay purposes. I'd now like to turn the conference over to your host for today, Jeff Norman, Senior Director Investor Relations. Please proceed, sir.

Jeff Norman - *Extra Space Storage Inc - Senior Director IR*

Thank you, Mark. Welcome to Extra Space Storage's fourth quarter 2014 conference call. In addition to our press release, we have furnished unaudited supplemental financial information on our website.

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, Friday, February 20, 2015. 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, Chief Executive Officer.

Spencer Kirk - *Extra Space Storage Inc - CEO*

Hello, everyone. 2014 was another outstanding year for Extra Space. We reached record high occupancies, drove rates, controlled our expenses and produced exceptional results.

For the year, same-store revenue growth was 7.5% and NOI growth was 9.5%. Occupancy ended the year at a record 91.4% up 190 basis points. Most importantly, FFO as adjusted increased 23.7%.

Despite heightened competition for properties on the open market we closed $531 million in acquisitions during 2014. We are off to a solid start in 2015 with $271 million in stabilized and lease up stores closed or under contract. In addition, we have $56 million in certificate of occupancy storage that will be completed and purchased in 2015.

I'll now turn the time over to Scott.

Scott Stubbs - *Extra Space Storage Inc - CFO & EVP*

Thanks, Spencer. Last night, we reported FFO of $0.62 per share for the fourth quarter and $2.52 per share for the year. Excluding costs associated with acquisitions, non-cash interest and the loss related to a fire, FFO as adjusted was $0.68 per share for the quarter and $2.61 per share for the year which was at the high end of our guidance.

We had a busy fourth quarter, acquiring 19 stores for $164 million. Of the 19 stores, 15 were sourced from our third party managed pool. Our relationships with our partners continued to provide an advantage in our acquisitions.

Subsequent to the end of the quarter, we acquired three stores for $42 million and have 28 stabilized and lease up stores under contract for $229 million for a total of $271 million. These acquisitions should close by the end of the second quarter.

Additionally, we have another 13 stores under contract that we will acquire upon receipt of a certificate of occupancy. The total purchase price of these stores is $138 million of which $56 million is expected to close in 2015.

Last night, we provided guidance and annual assumptions for 2015. Our new same-store pool will increase by 61 to 503 stores. We expect the change in same-store pool to positively impact our revenue growth which we will further detail with our Q1 results.

Our full-year 2015 FFO guidance is from $2.85 to $2.94 per share. FFO as adjusted is estimated to be $2.89 to $2.98 per share. This includes $0.03 of dilution from our 2014 and 2015 certificate of occupancy acquisitions.

Our guidance also includes acquisitions that currently operate below our portfolio average. We anticipate these stores will require time to be brought up to our performance standards. This limits year one accretion and is part of a long term strategy to leverage our operating expertise and to maximize shareholder return.

I'll now turn the time back to Spencer.

Spencer Kirk - *Extra Space Storage Inc - CEO*

Thanks, Scott. In 2015, we acknowledged that going up against the comps of 2014 will be difficult. As we have said many times, this level of year-over-year performance is not realistic to expect nor is it sustainable. Our results will roll back from extraordinary to really good.

That being said, I'm confident of three things. First, new supply will not be an issue in 2015. Second, we will continue to drive higher value customers to our stores and maximize revenue through rate and discount optimization. Third, Extra Space will deliver another year of double digit FFO growth, an impressive accomplishment in the Real Estate sector.

Now let's turn the time back to Jeff to start the Q&A session.

Jeff Norman - *Extra Space Storage Inc - Senior Director IR*

Thank you, Spencer. 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 everybody has had an opportunity to ask their initial questions. With that we will turn it over to Mark to start our Q&A session.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Your first question comes from Todd Thomas from KeyBanc Capital Markets.

Todd Thomas - *KeyBanc Capital Markets - Analyst*

Hi, thanks. Just first question on acquisitions. I was just wondering what caused the owners of the 15 properties that the XR acquired from third party managers to sell? Was this one portfolio or portfolio owned by one individual or entity or was it a number of individual sellers and what was the motivation there?

Scott Stubbs - *Extra Space Storage Inc - CFO & EVP*

We had two small portfolios, one with five properties and one with four. Both transactions, the seller wanted to get done by the end of the year.

Todd Thomas - *KeyBanc Capital Markets - Analyst*

Okay, and then just in terms of funding capacity for these acquisitions sort of what's under contract and what you see in the pipeline here. Balance sheet's in good shape from a leverage standpoint but you have over $200 million of maturities and the acquisition pipeline left to fund. S

o what's the plan to handle that throughout the year? And also along those lines, just curious you've commented in the past about migrating toward an investment grade rating, what are your thoughts there?

Scott Stubbs - *Extra Space Storage Inc - CFO & EVP*

So our guidance this year, our $500 million in acquisitions, assumes between $75 million and $100 million of shares being issued. Those will primarily be operating partnership units is our guess. The rest will be funded with debt.

As far as refinancing the debt, we don't think that that's going to be a problem at all. It's actually CMBS debt. $200 million of it comes due in August and we'll prepay it as soon as June. It's the earliest prepayment window that we have and we estimate we should get a pretty good decrease in rate with that.

As far as migrating the balance sheet to more investment grade our plan this year is to potentially do some unsecured bank debt is really the plan this year.

Todd Thomas - *KeyBanc Capital Markets - Analyst*

Okay, so but in terms of the $200 million of CMBS debt, your expectation is that you'll refinance that?

Scott Stubbs - *Extra Space Storage Inc - CFO & EVP*

We will refinance it, correct using bank debt, not CMBS. And it will likely be a combination of secured and unsecured bank debt.

Todd Thomas - *KeyBanc Capital Markets - Analyst*

Okay, got it. Thank you.

Scott Stubbs - *Extra Space Storage Inc - CFO & EVP*

Thanks, Todd.

Operator

Your next question comes from the line of Smedes Rose from Citi.

Smedes Rose - *Citigroup - Analyst*

Hi, it's Smedes. It looks like the number of C of O deals is accelerating in your pipeline and I was just wondering do you feel comfortable that you can keep dilution at still to 2% to 3% or are you willing to let that move up a little bit as these deals increase?

Spencer Kirk - *Extra Space Storage Inc - CEO*

Smedes, it's Spencer. We do like C of O deals. We also like being disciplined and that range of 2% to 3% is something that we're going to try and operate in. We're not really interested in having a lot of drag on our earnings going forward.

One way that we can address this is with a JV partner to help deal with the dilution. Obviously we get the management fees, the tenant insurance, we increase our platform so we get economies of scale and a JV partner is in fact already involved in what we're doing. We've got three properties with the JV right now. So we're going to manage the dilution.

Smedes Rose - *Citigroup - Analyst*

Okay, and then you mentioned in 2015 there's no new supply, it's not an issue. But what year or when do you think it does become more of an issue? It seems like on the last call there was from Public Storage, they mentioned that there is a lot more coming out of the ground maybe than people realize. I'm just curious your thoughts around that?

Spencer Kirk - *Extra Space Storage Inc - CEO*

Okay, so there are a lot of opinions on this. I can't speak to the prior call. What I can tell you is, as I traveled the country and as we go out and query our folks in the field, we talk with brokers, we meet with vendors, we talk with developers, we meet with local operators, there is interest in new supply. There's more talk I believe than action. I do believe that supply is coming but it needs to be kept into perspective.

My personal opinion is there might be 300 to 500 properties under construction in the US and that today is not even keeping pace with the population increase. So there's interest, there's a lot of talk but land prices are higher.

The difficulty of getting entitlements is not getting any more favorable and most people that are out there are recognizing that they're going to have to align themselves with a larger operator to compete on the internet. When you do that, you're going to be paying management fees, giving up some of the tenant insurance income and the return on that is likely to go down so it's not as compelling.

Last point I might add. If you say Public Storage has got $400 million under construction, the other REITs combined maybe have another $400 million under construction, call it $800 million, you might have 100 properties being produced by the REITs. And we're in the best position to capitalize on the return versus risk profile.

So, I think it's muted. We'll have to see how 2016 and 2017 shape up but 2015, I don't think it's an issue.

Smedes Rose - *Citigroup - Analyst*

Okay, that's very helpful. Thank you.

Spencer Kirk - *Extra Space Storage Inc - CEO*

Thanks, Smedes.

Operator

Your next question comes from the line of Ross Nussbaum from UBS.

Ross Nussbaum - *UBS - Analyst*

Hi, guys. Two questions. First is on the balance sheet. You guys have about $845 million of variable rate debt, which I think is about 35% of your total debt load, which is on the higher side in the REIT industry. Do you guys have any plans to -- you talked about doing that bank debt.

Is the game plan to repay the floating rate debt? Do you have any plans to put some swaps on, term this debt out? Can you talk about that variable rate exposure?

Scott Stubbs - *Extra Space Storage Inc - CFO & EVP*

Yes, our quarter, for the end of the year we finished at 35%. It's right around 35% and it's actually slightly higher depending on where your lines of credit are.

So at the end of the quarter when we had some lines that were partially drawn it caused it to be slightly higher. What we are doing today is we are looking to -- the debt we're putting on we're fixing whereas we allowed a certain portion to go variable over the last two years.

And that will fix a large percentage of that going forward or the new loans coming on. So we don't see it going any higher, the percentage of variable rate debt.

Ross Nussbaum - *UBS - Analyst*

But you're not actively going to push it materially lower?

Scott Stubbs - *Extra Space Storage Inc - CFO & EVP*

We will manage it and I don't know that it's necessarily going to be materially lower. It probably depends a little bit on how you define material. I think it's going to be plus or minus 10% -- I mean, you might go to 25% variable rate.

Ross Nussbaum - *UBS - Analyst*

Okay, the other question I had is just conceptually on rate growth. I'm wondering in terms of realized rate growth, based on what you're seeing competitively and what potentially the supply pipeline could be as we look maybe a year or 18 months ahead, is it realistic to think that rate growth can get much better than call it the 5%-ish somewhere in the 5%s? And that's kind of where things are going to settle out or is there any reason to believe it can be better than that?

Scott Stubbs - *Extra Space Storage Inc - CFO & EVP*

I think that you've seen the last few years be really as good as the self-storage industry has ever experienced. And the rate growth has been in that 4% to 5% range with some of us experiencing gains in occupancy. So I'm not sure it's going to get significantly better, especially with new supply coming.

Ross Nussbaum - *UBS - Analyst*

Thank you.

Operator

Your next question comes from the line of Ki Bin Kim from SunTrust.

Ki Bin Kim - *SunTrust Robinson Humphrey - Analyst*

Thank you. Spencer, you talked about this a little bit in the beginning opening remarks, but in regards to your 7% same-store NOI guidance for 2015, how much does the same-store pool changing impact that number?

Spencer Kirk - *Extra Space Storage Inc - CEO*

We don't know exactly yet, Ki Bin. We're goes to guesstimate maybe 50 basis points.

Ki Bin Kim - *SunTrust Robinson Humphrey - Analyst*

Okay, that's helpful. And second question, if the market, going back to street rate side, if the market doesn't increase, the market rents street rates don't increase this year, let's say it's flat year-over-year, how much embedded rent growth or how much embedded same-store revenue growth can your portfolio produce given the trend in higher street rates we've experienced in the past couple years and the trend in lower promotions? So without any new market rent growth what could the organic growth of this current portfolio be?

Scott Stubbs - *Extra Space Storage Inc - CFO & EVP*

For 2015, just kind of maybe giving you a little bit bigger picture, we're estimating rate growth to be 4% to 5% with occupancy being 1.5%. And then our existing customers is adding maybe another 50 basis points. So if you strip out the 4% to 5%, you're talking 2% growth. But we do anticipate that you will have rate growth in 2015.

Spencer Kirk - *Extra Space Storage Inc - CEO*

One of the interesting things, Ki Bin, is our strategy in the shoulder season has been to not be aggressive on rate and actually hold occupancy. If you'll look at what happened in the forth quarter, instead of occupancy going down we did a decent job and as we look at what's happening in the first quarter occupancy certainly is holding. So, we're already seeing some strength in pricing power and although that is a scenario that could play out, I'm skeptical that it would.

Ki Bin Kim - *SunTrust Robinson Humphrey - Analyst*

Okay, all right. Thank you.

Scott Stubbs - *Extra Space Storage Inc - CFO & EVP*

Thanks, Ki Bin.

Operator

Your next question comes from Ryan Burke from Green Street Advisors.

Ryan Burke - *Green Street Advisors - Analyst*

Thank you. Spencer, I'm curious what impact lower gas prices have on the mind set of the storage consumer? Have you seen any changes in your customers' decision-making patterns and have you made any specific operational adjustments as the price of gas has come down?

Spencer Kirk - *Extra Space Storage Inc - CEO*

No, no, and no. So I'm not trying to be smart alec, Ryan. The answer is this. There are numerous demand drivers for self-storage.

The best thing that I can tell you is overall consumer confidence and overall health of our economy is best for our business. But to selectively drive it down to one single element like gas prices, we can't measure it, we can't track it and we don't know.

Ryan Burke - *Green Street Advisors - Analyst*

So likely a positive impact just extremely difficult, probably impossible to quantify?

Spencer Kirk - *Extra Space Storage Inc - CEO*

Yes.

Ryan Burke - *Green Street Advisors - Analyst*

Okay, second question, you've often talked about the fact that you're building a company, you're not shrinking a company so therefore, dispositions haven't made much sense in the past. Is there a point where cap rates get so low that you become more inclined to sell assets, particularly with the amount of external growth that you have on the pipeline?

Spencer Kirk - *Extra Space Storage Inc - CEO*

You know, this is a difficult question for us strategically. Because when you think of wholly owned assets, partially owned assets, i.e, JV and non-owned assets, meaning the managed assets and third party relationships. When you start selling assets that might be wholly owned in a particular market, obviously you're giving up some revenue and income and you might be redeploying it not to your advantage because you might be selling at a 6.5 or a 7 and then having to redeploy it at something less than that in another market.

But the biggest problem for us or challenge rather is the operational efficiency in those markets where we have meaningful mass and momentum. And to further impede our efficiency and economies of scale by getting out of the markets, we economically have not figured out how to do that. There may be a few out in the periphery but in the main, because of our unique structure, it's difficult to dispose and not have some adverse economic impact.

Ryan Burke - *Green Street Advisors - Analyst*

Okay, thank you.

Jeff Norman - *Extra Space Storage Inc - Senior Director IR*

Thanks, Ryan.

Operator

Your next question comes from the line of George Hoglund from Jefferies.

George Hoglund - *Jefferies & Co. - Analyst*

Yes, hi. Just wanted to check on the acquisition environment and check if there's any sort of larger portfolios out there that you guys are seeing?

Spencer Kirk - *Extra Space Storage Inc - CEO*

You know, George, one of the things that I think most of the REITs would talk about is over the course of the last several years, there's been a fair amount of acquisition activity. I think we've all done quite well.

I think it's also important to note that a lot of low hanging fruit has already been plucked. So as we think about large portfolios out there that might be available in 2015, there's talk. There are rumors. But I'm not aware of anything substantive today that would cause us to change our guidance.

George Hoglund - *Jefferies & Co. - Analyst*

Okay, and then also in terms of the competitive landscape, are you seeing any change from the smaller competitors in terms of them getting better on terms of an internet marketing perspective or from an operating perspective?

Spencer Kirk - *Extra Space Storage Inc - CEO*

I think they are migrating in terms of sophistication. I will say generally, but while everybody has now got a website up that works in the world of desktop and laptop, the move to mobile has been so rapid that I think once again, many of the smaller operators are disadvantaged because they can't create platforms that optimize all of the different mobile applications and hardware platforms out there.

And I think it's the large publicly traded REITs that continue to have an advantage as the market continues to evolve on the technology front. It takes a lot of manpower, it takes a lot of resources and I generally don't believe it's something that you can just farm out to some smaller less well capitalized group to optimize what is happening with the ascendancy of the mobile device.

George Hoglund - *Jefferies & Co. - Analyst*

Okay, thanks and then just one small little nit on the $1.7 million of property casualty losses in Q4. Can you just provide some color on that?

Scott Stubbs - *Extra Space Storage Inc - CFO & EVP*

Yes, we had a fire at one of our properties in Venice, California. We are self-insured on a portion of it and that represents the net amount that it will cost us to rebuild a portion of that property.

George Hoglund - *Jefferies & Co. - Analyst*

Okay, thanks.

Scott Stubbs - *Extra Space Storage Inc - CFO & EVP*

Thanks, George.

Operator

Your next question comes from Todd Stender of Wells Fargo.

Todd Stender - *Wells Fargo Securities, LLC - Analyst*

Thanks. Just to get back to the 13 C of O deals under contract, can you go through the range of IRRs for that group? And can you describe how the return profiles for the three facilities that are going into a JV are different from the others?

Scott Stubbs - *Extra Space Storage Inc - CFO & EVP*

So the three properties that are going into the JV are ones that we took to our JV partner and had them, we're going to take more and more to them but they were some of the ones that came in a little bit later. We had some already going when we established the joint venture, so those did not go to the joint venture.

Going forward we are taking the majority of those to that JV partner. As far as the range of IRR, an unlevered IRR is going to be high single digits.

Todd Stender - *Wells Fargo Securities, LLC - Analyst*

And for you to send or give investment opportunities to the JV, is that an obligation you're under or these just don't fit your return hurdles?

Scott Stubbs - *Extra Space Storage Inc - CFO & EVP*

We have a commitment to supply to them a certain amount as far as volume.

Todd Stender - *Wells Fargo Securities, LLC - Analyst*

Okay thanks, Scott. And then just from a bigger picture perspective, what's your appetite for expanding outside of the top 25 MSAs? I guess as you look out over the next couple of years, evaluate acquisition candidates and some of the markets that you just have really steered clear of maybe in the past, how do you think about broadening your universe?

Spencer Kirk - *Extra Space Storage Inc - CEO*

So Todd, it's Spencer. I think our appetite is reasonable. I've said several times we're not going to get to 2,000 properties by being in Los Angeles and New York. We have to get outside of the Top 25 MSAs.

Top 50 MSAs sounds very appealing to us. I think that's been proven with another company and I think it's a strategy that can work well for Extra Space going forward.

Todd Stender - *Wells Fargo Securities, LLC - Analyst*

Thanks, guys.

Jeff Norman - *Extra Space Storage Inc - Senior Director IR*

Thanks, Todd.

Operator

Your next question comes from Michael Salinsky from RBC Capital Markets.

Michael Salinsky - *RBC Capital Markets - Analyst*

Hi, good afternoon guys. Scott, you went through a good detail on the revenue components there driving that. Can you give us just the same kind of break out of what's driving the pressure on expenses in 2015 relative to 2014?

Scott Stubbs - *Extra Space Storage Inc - CFO & EVP*

Yes, our biggest expenses, our biggest expense increase in 2015 is going to relate primarily to property taxes. In our same-store pool we are budgeting a 5% increase in property taxes and roughly a third of our expenses relate to property taxes. So by giving a range that we did, it's really property taxes with some lower inflationary increases on payroll and some other items.

Michael Salinsky - *RBC Capital Markets - Analyst*

Okay, that's helpful. Then just as my second question, just going back to the pick up in activity in the fourth quarter and then year-to-date. Has there been any change in underwriting standards? And then, just looking at the growth rates being under written in your IRR analysis, 12 to 18 months ago versus currently, has that changed as you progress later in the cycle and you have supply on the horizon?

Scott Stubbs - *Extra Space Storage Inc - CFO & EVP*

I think that the acquisition market is very competitive today. I think that obviously, all of the REITs are buying. I think you're seeing other types of capital chasing self-storage. It's caused cap rates to come down.

We want to be as disciplined as possible and provide the best return to our shareholders and one of the areas we've looked at obviously is certificate of occupancy. The other area we've tried to focus on is assets that are maybe underperforming our current standard today. So maybe a property on average is 75% and we have properties in the same market that are low 90%s.

That's something that's interesting to us and so we might be willing to be a little bit more aggressive on a year one cap rate for that property because in year two, year three it's really going to provide a pop and a benefit to the shareholders. Year one we might be willing to go in with very little accretion, which is something I talked about in my opening comments, as far as something we're focusing on.

Michael Salinsky - *RBC Capital Markets - Analyst*

So just in that note then, what was the going in cap rate on that properties purchased in the fourth quarter and then under contract versus where do you expect those to stabilize?

Scott Stubbs - *Extra Space Storage Inc - CFO & EVP*

I think it really varies quite a bit. If you look for instance at 2015, you know we're targeting a stabilized cap rate on a property that stabilized our standards of being 6 to 6.5 cap year one. That's where the management fee and with our expenses.

Certificate of occupancy deals are going to be zeros. They're dilutive actually in year one.

We also are looking at a portfolio, I mean a group of properties that might be a 3 to 5 cap in year one because they're not stabilized. Maybe their occupancy is 30% to 40%, maybe it's 70%. We're doing a blend of all of them so it's difficult to really say exactly what the cap rate was on one particular acquisition.

Michael Salinsky - *RBC Capital Markets - Analyst*

That's helpful, thank you.

Jeff Norman - *Extra Space Storage Inc - Senior Director IR*

Thanks, Mike.

Operator

(Operator Instructions)

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

Paul Adornato - *BMO Capital Markets - Analyst*

Thanks. Just wanted to follow-up on Spencer on your development comments. I think you said that you've thought that there were maybe 300 to 500 storage properties being developed right now in the US with the REITs accounting for about 100 of those. So what's the source of development capital for the rest of those?

Spencer Kirk - *Extra Space Storage Inc - CEO*

It's a variety of sources. It's the small local storage operator that's decided they want to finally expand from one to two stores. You've got private equity investing in some of these forays into the self-storage market.

I can't specifically pinpoint any one source. All I can say is because of the outperformance of the self-storage sector year over year over year, there's been a spotlight on self-storage and everybody has an interest in getting into the game.

It's just a lot more difficult than most people imagine and the return profile, as I spoke to earlier, is less favorable than in years gone by. So the 300 to 500 number is my best guess of what will come out of the ground and open in 2015.

There might be additional properties that are being contemplated or being worked on or entitled or whatever but my comment is I just don't see it being a factor in 2015. It's below the natural population increase.

Paul Adornato - *BMO Capital Markets - Analyst*

Okay, and I guess related to that, how many C of O deals do you see or are shown to you for every one that you do?

Spencer Kirk - *Extra Space Storage Inc - CEO*

That's hard to quantify, because there's a pretty good screening process but I would say at least 10 to 15.

Paul Adornato - *BMO Capital Markets - Analyst*

Okay, so is it fair to say that most of what's being built has been shown to at least one of the big operators?

Spencer Kirk - *Extra Space Storage Inc - CEO*

Not necessarily.

Scott Stubbs - *Extra Space Storage Inc - CFO & EVP*

I would say in core markets we see a lot of those. Maybe in some of the tertiary markets we don't see everything that's coming to market.

But in New York City I think we're aware of a lot or most of them in Dallas, we see a lot of them. But if you start getting into Wichita, Kansas, places like that, you might not see everything.

Paul Adornato - *BMO Capital Markets - Analyst*

Okay, great. Thanks for the color.

Scott Stubbs - *Extra Space Storage Inc - CFO & EVP*

Thanks, Paul.

Operator

Your next question comes from the line of Paula Poskon of D.A. Davidson.

Paula Poskon - *D.A. Davidson & Co. - Analyst*

Thank you very much. Spencer, you have long said that you thought operational consolidation would lead ownership consolidation and the acquisition activity out of the third party management pool of assets seems to be proving that true. Is that happening in line with the speed of your expectations? Is it happening faster or slower than you thought?

And what do you think is the biggest emphasis driving sellers to market? Is it the low cap rates? Is it just the natural generational estate planning? What do you think is the biggest driver?

Spencer Kirk - *Extra Space Storage Inc - CEO*

Okay, so being an impatient person, it's not going at the rate that I would like but I have to say in terms of where we are, I think Extra Space is doing very well. And what I mean is we've produced record results for these third party customers. And the question that they often ask is, if I sell you my asset, where am I possibly going to reinvest to get to this kind of return?

So there's a little reluctance right now. Nonetheless, first generation entrepreneurs getting a little bit older and thinking about estate planning is a primary driver.

Number two, our OP unit transactions are compelling. Not for everybody but for a good swath of the population that we have relationships with because it provides a tax deferred transaction. It allows for them to get a dividend and it also allows them to hopefully share in some appreciation in the stock price.

Those three items have spoken very well to a number of operators but not everyone. So, as we look forward I think that growing our third party management platform goes right back to the strategic reason why we entered into it in the first place and that is it's an off market acquisition pipeline and we proved again in Q4 that it adds real value to our shareholders.

Paula Poskon - *D.A. Davidson & Co. - Analyst*

And just one final follow-up on the third party platform. How important is it that you maintain your branding strategy? That you insist third party assets coming into your management platform rebrand to the Extra Space?

Spencer Kirk - *Extra Space Storage Inc - CEO*

It's important. It's a key focal point. We reject many opportunities when we have a hard discussion with an owner who isn't willing to put the CapEx dollars in to bring it up to our standard. And we walk away from far more deals than we actually bring in just because of the desire to have a consistency across wholly owned, partially owned and non-owned assets.

We are trying to build a brand and we try to enforce brand standards. But when we're not the one writing the check sometimes there's a little pushback. Coming in we have set a proper expectation that if you're going to be in our system there is a standard and we expect you to meet it.

Paula Poskon - *D.A. Davidson & Co. - Analyst*

That's all I have. Thank you very much.

Spencer Kirk - *Extra Space Storage Inc - CEO*

Thanks, Paula.

Operator

Your next question comes from Ross Nussbaum of UBS.

Jeremy Metz - *UBS - Analyst*

Hi guys, it's Jeremy on with Ross. I just had a quick follow-up on the CO deal. I was just wondering what you guys are seeing or at least what is being brought to you whether you're going forward or rejecting it. Are these existing projects that are already shovel ready or are you seeing developers locking up land rights with the hope of a retake out?

Scott Stubbs - *Extra Space Storage Inc - CFO & EVP*

We are seeing probably more of the second one there where many of these don't even have the land under contract. It's an LOI or it's a concept, just to see if it's something that works for us they'll bounce it off us. Occasionally we will see someone bring it to us that it's actually entitled and ready to go but that is actually more of the exception.

Jeremy Metz - *UBS - Analyst*

Okay and then the only second one, and sorry if I missed this, but just wondering what went on in Colorado? It seemed like you lost close to 600 basis points of occupancy there and saw some revenue declines?

Scott Stubbs - *Extra Space Storage Inc - CFO & EVP*

I think at our stabilized properties I wouldn't say so. I'm wondering if it's an addition of a managed property or managed pool of properties.

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Spencer Kirk - *Extra Space Storage Inc - CEO*

We'll take that offline, Jeremy.

Jeremy Metz - *UBS - Analyst*

Yes, okay. I know it's a small market. Thanks, guys.

Scott Stubbs - *Extra Space Storage Inc - CFO & EVP*

Thank you.

Spencer Kirk - *Extra Space Storage Inc - CEO*

Thanks, Jeremy.

Operator

Your next question comes from the line of Ki Bin Kim from SunTrust.

Ki Bin Kim - *SunTrust Robinson Humphrey - Analyst*

Thanks, just a couple quick follow-ups. I know you guys talked about your longer term variable rate debt percentage that you're comfortable with. But that is not just higher in self-storage REITs but kind of all REITs and just given where we are in the interest rate environment why not just take that down to pretty close to zero, excluding the line of credit, right?

Scott Stubbs - *Extra Space Storage Inc - CFO & EVP*

We are looking at it some, Ki Bin. In fact, we're looking at even doing forward swaps of some of the stuff that's out two and three years. We're not necessarily looking to be more aggressive but we do think it is prudent to have some exposure to the variable rate interest market and I think those who have had exposure over the last few years have won on that one. We recognize that we're likely in a rising interest rate environment but we do think it's prudent to have a combination of both.

Ki Bin Kim - *SunTrust Robinson Humphrey - Analyst*

Okay, and in terms of the C of O deals, especially the ones that are supposed to be within the JV structure, it seems like you have a 10% equity stake in those deals, smaller dollars and nominally. Do these deals come with a right of first refusal or some kind of contractual clause where you could take that 10% ownership up to 100% at a certain points in time? Because otherwise, why even bother with a 10% equity stake given the size of your company?

Scott Stubbs - *Extra Space Storage Inc - CFO & EVP*

We do have rights that allow us to take that from the 10% to 100% but it's not time based. It's basically when we come to that agreement or when our JV partner is looking to refinance, move out of the self-storage industry or show some returns. We do have an opportunity to take that to 100% and we agree it is a lot of work for 10% and that's why we have done probably more on balance sheet and less JV.

Ki Bin Kim - *SunTrust Robinson Humphrey - Analyst*

And when you say at an agreement is that a market price appraisal based pricing trigger or is it already kind of stipulated to be at what kind of multiple you'd be willing to pay as certain cash flow in the future?

Scott Stubbs - *Extra Space Storage Inc - CFO & EVP*

It's not based on a multiple or cash flow today. It's going to be more market and it's more of a buy-sell within the JV that's built into the operating agreement.

The other thing that it does for us by doing joint ventures is it also refreshes our portfolio. We're bringing new properties into the portfolio, so from a branding that type of thing it obviously really helps to have new properties in the portfolio.

Ki Bin Kim - *SunTrust Robinson Humphrey - Analyst*

Okay, thank you.

Scott Stubbs - *Extra Space Storage Inc - CFO & EVP*

Thanks, Ki Bin.

Operator

I would now like to hand the call over to Spencer Kirk for closing remarks.

Spencer Kirk - *Extra Space Storage Inc - CEO*

Thank you everyone for your interest in Extra Space today. We look forward to the Q2 earnings call. Have a good day.

Operator

Ladies and gentlemen, that concludes today's conference. Thank you for your participation. You may now disconnect and have a great day.

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