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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Extra Space Storage Inc. First Quarter 2017 Earnings Conference Call. (Operator Instructions) As a reminder, this conference is being recorded.

I would now like to introduce your host for today's conference, Mr. Jeff Norman, Vice President of Investor Relations. Sir, you may begin.

Jeff Norman - *Extra Space Storage Inc. - Senior Director of IR and Corporate Communications*

Thank you, James. Welcome to Extra Space Storage's First Quarter 2017 Earnings 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, Thursday, April 27, 2017. 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 Joe Margolis, Chief Executive Officer.

Joseph D. Margolis - *Extra Space Storage Inc. - CEO*

Hello, everyone. We kicked off 2017 with a solid first quarter, and fundamentals remain positive. We gained occupancy, grew street rates and increased same-store revenue by 5.8%. We demonstrated great expense control with a 2% decrease in same-store expenses. As a result, same-store

NOI grew 9.2%, and FFO per share as adjusted increased by 20%. We saw positive year-over-year revenue growth in all MSAs. We also saw acceleration of revenue growth in several MSAs, including Boston, Chicago and Philadelphia, demonstrating the cyclical nature of markets. We are enjoying the benefits of a well-balanced, diversified portfolio, operational scale and the ability to achieve outsized growth from stores added to our platform. We continue to be disciplined on the acquisition front, and we are committed to transact only at prices that will provide long-term value for our shareholders.

During the quarter, we added 2 wholly-owned stores and 2 joint venture stores for a total investment of $28 million.

In the quarter, we added 27 new properties to our third-party platform, and we have a robust pipeline of additional stores, which we will manage under the Extra Space brand. These managed stores will provide us additional fee income, density in key markets, customer data and potential future acquisition opportunities. Importantly, we are starting to see a more balanced mix of development and existing stores in our managed store pipeline.

I would now like to turn the time over to Scott.

P. Scott Stubbs - *Extra Space Storage Inc. - CFO and EVP*

Thanks, Joe. Last night, we reported FFO as adjusted of $1.03 per share, exceeding the high end of our guidance by $0.04. Revenues were in line with expectations, and the beat was primarily driven by property operating expenses. Property taxes and payroll were lower than expected, and utilities and snow removal were below budget due to a mild winter.

Our 2017 same-store pool increased by 168 stores for a total of 732. The change in the same-store pool added 110 basis points to revenue growth in the quarter, and we expect a benefit from the change in pool to average 50 basis points over the year.

Same-store NOI benefited 220 basis points from the change in pool during the quarter.

Beginning January 1, 2017, we have elected to exclude revenue and expenses related to tenant reinsurance from our same-store numbers. This quarter, we are presenting the impact of this change in our Q1 supplemental financial information, which shows the results of our 2016 and 2017 same-store pools with and without tenant reinsurance.

Occupancy for the same-store pool ended the quarter at 92.2% with an 80 basis point year-over-year increase. We were able to push our rates to new customers approximately 3% to 4% during the quarter. We experienced positive net rentals each month and continue to see steady demand.

In the first quarter, we did not access our ATM. Acquisitions and loan maturities were funded by draws on our credit facility. At quarter end, we had drawn $300 million on the term loans with $350 million in remaining term debt available. The revolving portion of the credit facility had a balance of $337 million with $163 million available. Subsequent to quarter end, we swapped $300 million from fixed to variable -- from variable rate to fixed rate debt on the 5-year term tranche.

We reaffirm our annual same-store revenue guidance of 4% to 5%. Due to the Q1 expense beat, we are lowering our annual expense guidance to 2.25% to 3.25%. As a result, we are increasing our annual NOI guidance to 4.25% to 5.75%. We also reaffirm our original acquisition guidance of total investment of $400 million. The mix has changed slightly and now includes $325 million in wholly-owned stores and $190 million in joint venture acquisitions and developments, with approximately $75 million in capital to be contributed by Extra Space. Approximately $150 million is currently closed or identified. Our guidance assumes the remaining unidentified acquisitions will close in the third and fourth quarter.

As a result of the Q1 beat, we are increasing our full year FFO as adjusted guidance to $4.21 to $4.29 per share. Our guidance includes $0.07 of dilution from our CofO stores and an additional $0.08 from value-add acquisitions for a total of $0.15.

I'll now turn the time back to Joe.

Joseph D. Margolis - *Extra Space Storage Inc. - CEO*

Thank you, Scott. We had a solid first quarter with growth in rates, rentals and occupancy, and we are well positioned heading into our busy season. Revenue deacceleration from our core assets continues to flatten, and we are seeing great performance from value-added acquisitions as they are integrated onto our platform. While we expect moderation in the back half of the year, we still expect stores to produce some of the best revenue growth in the real estate sector. We continue to monitor new supply in key markets to analyze its impact on our performance and to adjust operations at affected stores to minimize impact. While certain stores and markets have felt the impact of new development, it has not prevented us from experiencing positive revenue growth. Also, we are seeing reacceleration of revenue growth in some markets, including some that were on the front end of the development cycle.

In addition to maximizing same-store operating performance, we continue to utilize other tools that enhance FFO. We are focused on building our third-party management portfolio and pursuing high-yielding redevelopment and expansion opportunities at our existing stores. Such efforts, together with our solid operations, should lead to another strong year of FFO growth.

Let's now turn the time over to Jeff to start the Q&A session.

Jeff Norman - *Extra Space Storage Inc. - Senior Director of IR and Corporate Communications*

Thank you, Joe. (Operator Instructions) With that, we'll turn it over to James to start our Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Smedes Rose of Citigroup.

Bennett Smedes Rose - *Citigroup Inc, Research Division - Director and Analyst*

Joe, I was just interested, you mentioned a reacceleration of trends in some markets where development was kind of on the front end of the cycle. Could you maybe talk about which markets specifically you're seeing a reacceleration in?

Joseph D. Margolis - *Extra Space Storage Inc. - CEO*

I think the best example of that is Chicago, where we had a difficult time last year, and we're starting to come off of the floor there. Denver is another one, maybe not to the extent of Chicago. And I would just caution you, we're not saying it's a hockey stick, but we're saying we're moving in the right direction.

Bennett Smedes Rose - *Citigroup Inc, Research Division - Director and Analyst*

Okay, great. And then I just wanted to ask you quickly, you had mentioned on your last call that the visibility into '18 supply was difficult to get a good feel for. And I'm just wondering, we're a few months more into the year, do you have a better feel for where supply might end up in 2018?

Joseph D. Margolis - *Extra Space Storage Inc. - CEO*

I think that's a very difficult question. I mean, storage as a property type has a very short delivery cycle. You can build these stores relatively quickly. And we're continuing to see a significant, up to 60% fallout rate in the development projects that are in our ManagementPlus pipeline. And as unsatisfactory as an answer this is, I think that leads you to believe that there is not great visibility into next year.

Michael Bilerman - *Citigroup Inc, Research Division - MD and Head of the US Real Estate and Lodging Research*

Joe, would you -- it's Michael Bilerman speaking. How do you think about, PSA will talk about what the public REITs are doing and extrapolate that based on the public market shares -- share of the industry. So they would take the 5.25, 5.3 that's being developed by the public REITs, take 13% and say there's 45 million, 46 million square feet of development. I guess, how would you look at it overall? Do you think that over, under estimates or is an accurate estimate of the amount of supply that's coming online?

Joseph D. Margolis - *Extra Space Storage Inc. - CEO*

I have great respect for Ron and Public Storage, but I don't know the assumption that the percentage that the publics are developing versus the overall market will give you an accurate read.

Operator

Our next question comes from Juan Sanabria of Bank of America.

Juan Carlos Sanabria - *BofA Merrill Lynch, Research Division - VP*

I was just hoping you could comment on street rate growth trends during the quarter and into the second quarter and if there was any significant variance between the same-store pool last year and this year where you included SmartStop.

P. Scott Stubbs - *Extra Space Storage Inc. - CFO and EVP*

Yes. This is Scott. I will tell you the street rates grew -- street and achieved rates grew at 3% to 4% in the quarter. That continues into April. And I would tell you the SmartStop rates are actually probably slightly lower than that as we continue to gain occupancy at those properties. But it's been steady at the 3% to 4%.

Juan Carlos Sanabria - *BofA Merrill Lynch, Research Division - VP*

Okay, great. And then what should we think of as driving the deceleration in the SmartStop contribution that you said you're holding the 50 basis point contribution to same-store revenue for the year? Is that just filling up the stores and having kind of less low-hanging fruit?

P. Scott Stubbs - *Extra Space Storage Inc. - CFO and EVP*

Tougher comps. You're coming up against -- it was already performing fairly well in the back half of last year. And as this year compares to the back half of last year, those comps get tougher.

Juan Carlos Sanabria - *BofA Merrill Lynch, Research Division - VP*

Okay. If I can squeeze in one last quick one. You talked about a 60% fallout on your developments on your platform. Any sense of what that was historically?

Joseph D. Margolis - *Extra Space Storage Inc. - CEO*

It's ticked up slightly, but I wouldn't put too much credence in that. It's been pretty steady at between 40% and 60% over last year.

Operator

Our next question comes from George Hoglund of Jefferies.

George Andrew Hoglund - *Jefferies LLC, Research Division - Equity Associate*

Just in terms of how you're looking at acquisitions for the rest of the year and what would have to happen to sort of change acquisition volume, I mean, obviously, a better stock price would help. But in terms of kind of where pricing is today, where your stock is, how much of a Delta is there between kind of where pricing is and where it would have to be to get you guys more active?

Joseph D. Margolis - *Extra Space Storage Inc. - CEO*

We're not pricing acquisitions on our stock price on any particular day. Our stock price is going to go up or down. I have no idea why our stock price goes up and down. And we're trying to find acquisitions that produce long-term value for our shareholders without kind of comparing it to spot pricing of our stock. What we're looking and hoping to happen so we can acquire more properties at the back end of the year is that cap rates expand and sellers' expectations for pricing come more in line with what we're willing to pay for properties.

George Andrew Hoglund - *Jefferies LLC, Research Division - Equity Associate*

And any sort of general sense kind of ballpark sort of on a cap rate basis, ROE 50, 100 bps away or how far?

Joseph D. Margolis - *Extra Space Storage Inc. - CEO*

Yes, I think that's probably a pretty fair range.

Operator

Our next question comes from Ryan Burke with Green Street Advisors.

Ryan Cole Burke - *Green Street Advisors, LLC, Research Division - Analyst*

Joe, was I correct in hearing you in your prepared remarks referencing that you're seeing a more balanced mix of development and stabilized properties in the managed pipeline?

Joseph D. Margolis - *Extra Space Storage Inc. - CEO*

Yes, that's correct.

Ryan Cole Burke - *Green Street Advisors, LLC, Research Division - Analyst*

Would you mind just elaborating a little bit further just to explain what you mean and why it's important, notable?

Joseph D. Margolis - *Extra Space Storage Inc. - CEO*

So in 2016, the vast majority of projects that we signed up for and that people were inquiring about to have us manage their stores for them were new developments. And now we're starting to see more existing owners, I think, as the going gets a little tougher, realize they need professional management. And we're having more and more discussions with existing owners. 40% of the properties we brought on in the first quarter were existing properties. And that's important because when you bring an existing property on, we start making money right away because it's full, and our fee is a percentage of revenue. And when you bring on a development property, it's not as profitable until you can lease it up.

Ryan Cole Burke - *Green Street Advisors, LLC, Research Division - Analyst*

Okay, makes sense. There has been some talk of smaller developers potentially becoming a little bit uneasy about the operating environment and potentially looking to sell actually sooner than they otherwise would have. Are you guys seeing that?

Joseph D. Margolis - *Extra Space Storage Inc. - CEO*

I don't think we're seeing enough of that to call that a trend.

Ryan Cole Burke - *Green Street Advisors, LLC, Research Division - Analyst*

Last question. Any update on the potential disposition portfolio?

Joseph D. Margolis - *Extra Space Storage Inc. - CEO*

Sure. So to be clear, we're looking to recapitalize a portfolio to sell a majority interest in it or transfer it to a JV in which we would own a minority interest, keep it under the Extra Space platform. We are undergoing a process. We've collected first round bids, and we're in a process. And we'll talk more about it when we're done.

Ryan Cole Burke - *Green Street Advisors, LLC, Research Division - Analyst*

Are you able to provide any color about the likelihood of that being a new JV partner versus an existing partner?

Joseph D. Margolis - *Extra Space Storage Inc. - CEO*

We really can't say until we know where we end up.

Operator

Our next question comes from Todd Thomas of KeyBanc Capital.

Todd Michael Thomas - *KeyBanc Capital Markets Inc., Research Division - MD and Equity Research Analyst*

First question, just around this time last year, there's some softness in demand set in around the start of the peak leasing season. And I'm just wondering if you could comment on how the beginning of the peak season has been so far here and if you're doing anything differently this year having observed that softness last year.

P. Scott Stubbs - *Extra Space Storage Inc. - CFO and EVP*

So this year versus last year, I would tell you this year has been steady so far. Last year, we were probably a little bit more aggressive on pricing and year-over-year, we were not spending extra on the Internet. Our year-over-year marketing cost last year actually went down. This year, we're spending more. Our budgets are a little bit higher, so that potentially -- lower prices, higher marketing spend is yielding -- it's a good yield for us this year.

Todd Michael Thomas - *KeyBanc Capital Markets Inc., Research Division - MD and Equity Research Analyst*

Okay. But you're not seeing market pricing or any increase in competition necessarily create softness so far at this point in the beginning of the peak leasing season?

P. Scott Stubbs - *Extra Space Storage Inc. - CFO and EVP*

Year-to-date, we have not. Our rentals, our demand has been steady to slightly up, and our rates are still 3% to 4% above where they were last year. So we'd classify that as a solid year.

Todd Michael Thomas - *KeyBanc Capital Markets Inc., Research Division - MD and Equity Research Analyst*

Okay. And then just following up on the impact from the SmartStop portfolio. So it sounds like you're expecting the year-over-year contribution to be fairly muted by year end, so essentially no benefit. Is that the right read? And is that what's embedded in guidance?

P. Scott Stubbs - *Extra Space Storage Inc. - CFO and EVP*

That is correct, and that is what is embedded in guidance.

Operator

Our next question comes from Gwen Clark with Evercore ISI.

Gwendolyn Rose Clark - *Evercore ISI, Research Division - Research Analyst*

Can you guys give us a rundown of how your largest markets fared relative to expectations and whether there were any surprises in the quarter?

P. Scott Stubbs - *Extra Space Storage Inc. - CFO and EVP*

So first thing I would tell you is our markets -- in our supplementals, we disclosed 2 things. We disclosed our same-store and then also our mature pool. And I think that there is a little noise in both of those disclosures in the supplement in that SmartStop has been added to both of those pools as well as the larger Dallas acquisition, which we did last year. So a few of those markets could potentially be overstated as a result of adding those properties. I would tell you, Los Angeles continues to do well. Sacramento, to a lesser degree, continues to do well. It's had good growth for -- now this is onto the third year. I would tell you we would probably expect that to tail off. It's been 15-plus percent for a long period of time. Boston is not doing as well, but it has bounced back some. And then Houston and Dallas continue to slide a little bit.

Gwendolyn Rose Clark - *Evercore ISI, Research Division - Research Analyst*

Okay, that's helpful. Just one quick follow-up. On the topic of California, have you seen any signs that supply is going to pop up in the larger metro areas that you're in?

Joseph D. Margolis - *Extra Space Storage Inc. - CEO*

So we're very focused on South Orange County and Irvine Company is very aggressively building. We're managing those stores, so we know them, but there's a good amount of supply coming there. San Jose and San Diego are the 2 markets we're looking at.

Gwendolyn Rose Clark - *Evercore ISI, Research Division - Research Analyst*

You mean in terms of supply coming on or you're looking to build?

Joseph D. Margolis - *Extra Space Storage Inc. - CEO*

Right -- no. I'm sorry. I'm sorry to be unclear. San Jose and San Diego are 2 markets that there is some supply coming on, and we're looking at that and trying to understand it.

Operator

(Operator Instructions) Our next question comes from Jon Hughes with Raymond James.

Jonathan Hughes - *Raymond James & Associates, Inc., Research Division - Senior Research Associate*

Same-store revenues were up 4% in the overall New York same-store pool. But could you tell us what the revenue growth was in the 61 assets that are in the old same-store pool?

P. Scott Stubbs - *Extra Space Storage Inc. - CFO and EVP*

Our New York market did not see a huge benefit -- or a huge difference between the 2 pools, so it was slightly less in the old same-store pool. We have seen a difference between New York, Northern New Jersey and the Boroughs. The Boroughs are not doing as well. But we do not have as much exposure to the Boroughs, so we may not have enough exposure for it to be a good sample size. But we are seeing slower growth in the Boroughs and better growth in Northern New Jersey and Long Island.

Jonathan Hughes - *Raymond James & Associates, Inc., Research Division - Senior Research Associate*

Okay. Appreciate that. And then why was vacate activity so favorable during the quarter? I'm just curious to know if same-store rentals and vacates were materially different across the old same-store pool and the 170 assets added this year.

P. Scott Stubbs - *Extra Space Storage Inc. - CFO and EVP*

You're hard part, I would tell you, is you're always comparing to the prior year, and it depends a little bit on what happened last year. But I think that I wouldn't focus too much on year-over-year. But we did have a mild winter this year, but last winter was not terrible either so...

Jonathan Hughes - *Raymond James & Associates, Inc., Research Division - Senior Research Associate*

Right. Okay, fair enough. Just one more quick one, and sorry if I missed it earlier, but can you give us an update on occupancy today or the most recent number you have?

P. Scott Stubbs - *Extra Space Storage Inc. - CFO and EVP*

It's not that different from where we ended the quarter in terms of year-over-year.

Operator

Our next question comes from Vikram Malhotra of Morgan Stanley.

Vikram Malhotra - *Morgan Stanley, Research Division - VP*

Just on the expense side, could you maybe just highlight if there are any onetime items? And particularly property taxes, what are your expectations for the balance of the year?

P. Scott Stubbs - *Extra Space Storage Inc. - CFO and EVP*

Yes. If you look at the first quarter and how we performed quarter versus our budget, I would tell you our property taxes came in lower than we expected. We -- our property taxes beat our budgets by about $1.2 million and about -- just over half of that was a result of either appeals that -- where we had favorable outcomes or adjustment to existing accruals on the SmartStop and the other Assured portfolios with properties in Texas and Illinois. When we bought the properties, we used property tax consultants to accrue on those for the first year, 1.5 years now. And those 2 states report on a lag. When we got the final bills, we ended up reversing accruals to the tune of about $0.5 million. So we would tell you that those are benefits that we don't expect to see throughout the year. We also had some benefit from payroll versus our budget, but we think we're still early in the year, and it's probably a little bit too early to see whether or not that's going to continue throughout the year.

Vikram Malhotra - *Morgan Stanley, Research Division - VP*

Okay. And then just a bigger picture question on this revenue growth as you look out. If I'm correct, last year, you mentioned your view was that trends would decelerate but will sort of trend towards long-term average. Your long-term average revenue growth, if I'm not correct, over a 10-year basis is about 4.9%. And your core pool is probably growing around in the high 4s. What are your expectations as you look out over the next few quarters? Are you sort of now trending at that long-term number and you expect it to be there? Or could there be -- is there a likelihood of further deceleration?

P. Scott Stubbs - *Extra Space Storage Inc. - CFO and EVP*

So I think our guidance implies that you decelerate some more through the year. But we think it's still going to be in that 4% to 5% for the range. And dependent on where you are in that range, you could go below that or you could stay at the 4% to 5% range, depending on where you're estimating we're going to end for the year.

Operator

We have a follow-up question from Todd Thomas with KeyBanc Capital Markets.

Todd Michael Thomas - *KeyBanc Capital Markets Inc., Research Division - MD and Equity Research Analyst*

I just wanted to follow-up on the mix of projects in the third-party management portfolio. So you noted you're seeing more operating assets in the pipeline there. Is the interest from developers down? Or is the overall pipeline up with the incremental demand just coming from existing owners?

Joseph D. Margolis - *Extra Space Storage Inc. - CEO*

So about a year ago, we had 150 properties in the pipeline, and we have about 300 in the pipeline now. So both the pipeline has increased, and the mix, the percentage of existing in the pipeline has increased.

Todd Michael Thomas - *KeyBanc Capital Markets Inc., Research Division - MD and Equity Research Analyst*

And when you talk about it as a pipeline, those are future potential third-party management contracts that you're discussing terms and hoping to land, right?

Joseph D. Margolis - *Extra Space Storage Inc. - CEO*

Exactly. So it's potential. And we know that we're not going to get all of them, but we also know we're going to continue to add to the pipeline.

Todd Michael Thomas - *KeyBanc Capital Markets Inc., Research Division - MD and Equity Research Analyst*

Sure. And then do you have any sense in talking to the operators of the existing assets exactly what it is that's causing them to turn to third-party managers now? I mean what is it that they're seeing out there that's becoming a little bit more challenging in a sense?

Joseph D. Margolis - *Extra Space Storage Inc. - CEO*

So we're experiencing revenue deacceleration in our portfolio. And we know that folks who don't have our platform and our systems are less able to deal with the tougher market. And I think that as maintaining performance gets harder, more and more individual operators will turn to professional management.

P. Scott Stubbs - *Extra Space Storage Inc. - CFO and EVP*

Todd, I would add that you're also coming off the 2 best years. I mean for the last 2 years, they were feeling pretty good about operations and didn't feel like they needed any help. As things slow, they may look for help.

Todd Michael Thomas - *KeyBanc Capital Markets Inc., Research Division - MD and Equity Research Analyst*

Got it. And then just lastly, you mentioned the potential opportunity for redevelopment and expansions and that, that will become an increasing focus for the company. How big is that opportunity in terms of dollars and also the potential increase in rentable square feet? And what's the time frame that you're thinking about in order to extract that value?

Joseph D. Margolis - *Extra Space Storage Inc. - CEO*

Sure, good question. So historically, we've always targeted $30 million to $40 million of kind of value-add activity. And now we've taken some of our acquisition resources and focused on our existing portfolio. We have about 55 projects in the pipeline now, some were from -- in financial underwriting to feasibility to preconstruction and a couple under construction. It's about $175 million worth of projects, double-digit returns, and we'll continue to try to push more projects into that pipeline. The difficult part -- the difficult question to answer is timing because many of these involve getting some type of entitlements, and it's difficult to predict how long that will take in all the different jurisdictions.

Operator

I'm not showing any further questions at this time. I'd like to turn the call back over to Mr. Margolis for closing remarks.

Joseph D. Margolis - *Extra Space Storage Inc. - CEO*

I want to thank everyone for their time today, for their interest in Extra Space. And we look forward to catching up at NAREIT. Thank you very much.

Operator

Thank you. Ladies and gentlemen, that does conclude today's conference. Thank you very much for your participation. You may now disconnect. Have a wonderful day.