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EXR - Q1 2014 Extra Space Storage Inc. Earnings Conference Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the first quarter 2014 Extra Space Storage Inc., earnings conference call. My name is Gwen, and I'll be your operator today. (Operator Instructions). I would now like to turn the call over to Mr. Clint Halverson, VP of Investor Relations. Please, proceed.

Clint Halverson - *Extra Space Storage Inc. - VP Corporate Communication & IR*

Thank you, Gwen. Welcome, everyone, to Extra Space Storage's first quarter 2014 conference call. In addition to our press release we furnished un-audited supplemental financial information that you can access on our web site. Please remember 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, April 29, 2014. 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. With that, I would now like to turn the call over to Spencer Kirk, CEO.

Spencer Kirk - *Extra Space Storage Inc. - CEO*

Good afternoon. During last quarter's conference call I commented we were coming off of two years of superior results and were heading into what would be a great year. We are seeing signals that this is materializing.

Core performance was ahead of expectations. We held rates flat in the off season to drive occupancy and we ended the quarter up 200 basis points at 90.4%. Same store revenue was up 7.9%, with expenses growing at 4.7%. NOI growth was 9.4%. For same store properties experienced high snow removal and utility costs due to the severe winter weather. However, this was offset by lower than expected payroll and property tax expenses. As we move into our rental season we're seeing pricing power in higher street rates and lower discounts. I would now like to turn the time over to Scott.

Scott Stubbs - *Extra Space Storage Inc. - EVP, CFO*

Thanks, Spence. Last night, we reported FFO of $0.55 per share for the first quarter. Adjusting for non-cash interest expense and acquisition related costs, FFO was $0.57 per share. We out performed our guidance due to better than expected property performance, tenant insurance results and lower G&A and interest expense. Since going public nearly ten years ago our definition much our same store pool has not changed. In 2014 we added 99 properties to our same store pool, bringing the total to 443. 90 of these properties were from our previous acquisitions, and nine came from our development pipeline.

This change in our same store pool added about 80 basis points to our revenue growth. We had another strong quarter for acquisitions. We purchased 21 assets for $250 million. 17 of these properties came from a single portfolio in Virginia. Subsequent to the end of the quarter, we closed five additional properties for $61 million. We currently have four properties under contract for $39 million, which should close by the end of the second quarter. Therefore, as of today, we have closed or have under contract $350 million.

We revised our full year 2014 FFO guidance to be from $2.41 to $2.49 per share. These estimates include non-cash interest expense, and acquisition related costs. Adjusting for these items, FFO is estimated to be from $2.45 to $2.53 for the full year. I'll now turn the time back to Spencer.

Spencer Kirk - *Extra Space Storage Inc. - CEO*

Thanks, Scott. After all is said and done, our job as a management team is to grow FFO and increase shareholder value. The first quarter has added to a two-year run of excellent results. FFO per share grew by 24%, which marks 14 consecutive quarters of double-digit FFO growth. At this point we don't see anything that would preclude us from delivering another strong year. Let's now turn the time over to Clint to start the Q&A session.

Clint Halverson - *Extra Space Storage Inc. - VP Corporate Communication & IR*

Thanks, Spence. As in the past, in order to ensure we have adequate time to address everyone's questions I would like to ask that everyone keep your initial questions brief, and if possible limit it to two. If time allows, we'll address follow on questions once everyone has had an opportunity to ask their initial questions. With that, we'll now turn it over to Gwen to start our Q&A session.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Our first question comes from the line of Todd Thomas, of KeyBanc Capital Markets. Please, proceed.

Todd Thomas - *KeyBanc Capital Markets - Analyst*

Hi, thanks. Jordan Sadler is on the line with me, as well. The first question, in terms of the rank growth and the pricing power, I was just curious if you could tell us where street rates are today versus scheduled in-line rents for the portfolio and maybe you could just elaborate a little bit more on the pricing power that you commented on. Is it lower concessions and discounting primarily or are you seeing more traction in the ability to raise face rents or street rates.

Spencer Kirk - *Extra Space Storage Inc. - CEO*

Let's back up just a little bit. As we entered the off season, Todd, we said we're going to hold rates and drive occupancy, which actually worked out very well. At the end of March, our street rates were up about 3%. And as we walk into the busy season, we expect to be pushing rates, obviously how the year turns out depends on how far we can push those street rates. In terms of in place, rates were right on top of where we have been. There has been no material change in that.

Todd Thomas - *KeyBanc Capital Markets - Analyst*

Okay. Have you seen renters respond differently to rent increases that you pushed through? Whether by not moving out at the same rate as you had in the past or just less push back overall?

Spencer Kirk - *Extra Space Storage Inc. - CEO*

No, actually, Todd, it's combination of pushing the street rate or reducing the discount. And we're not trying just one single strategy, as we look at our revenue management system we're employing a variety of strategies to maximize the revenue. It depends on the customer, the channel, when they came to us, and what we know about that customer. And I think it's fair to say that we're not seeing any material change in consumer behavior, as we've applied our pricing strategy.

Todd Thomas - *KeyBanc Capital Markets - Analyst*

Okay. And just one question, and then I'll hop off. Related to the interest expense assumptions, I saw they came down $5 million for the year, and I was just curious last quarter when you provided guidance you had most of the acquisitions either completed or under contract that you announced with the earnings last quarter. I think this quarter there was roughly an incremental $50 million that we learned about. I was just wondering what drove that interest expense assumption down so much? Why was that not baked in more last quarter when you provided initial guidance?

Scott Stubbs - *Extra Space Storage Inc. - EVP, CFO*

Yeah, Todd, this is Scott. Our guidance really moves about $5 million like you mentioned, and about half of that is really a non-cash item. So what it is, is you're taking a game gain basically from some out of market debt due to some acquisitions, and that was a last minute thing that we recorded, as part of the acquisition of one of our joint ventures. And so, effectively what's happening is you're reducing your interest expense by $2.5 million, and you can see in the last part of our guidance it shows that you're basically taking that benefit back out. So, for FFO adjusted there's really no effect from that. So, the other $2.5 million comes from really three components. One, is we've elected to have three different loans. We had partially swapped and we were originally going to swap the entire amount.

We've elected to have a portion of that remain variable, and that benefits us to the tune of about $700,000. In addition, the LIBOR curve changed to where it's about a half a million dollars benefit in the year. That's $1.2 million in total between LIBOR and allowing these loans to float instead of fixing them. And then the rest comes from adjusting our amortization of loan fees, and we basically just trued that up from our run rate in prior years where in prior years we had a little bit of additional write off relating to that. Half non-cash, half cash, largely relating to variable rate loans and LIBOR.

Todd Thomas - *KeyBanc Capital Markets - Analyst*

Okay. Great. That's helpful. Thank you.

Spencer Kirk - *Extra Space Storage Inc. - CEO*

Thanks, Todd.

Operator

Our next question comes from the line of Christie McElroy with CitiGroup. Please proceed.

Christy McElroy - *CitiGroup - Analyst*

Good morning. I would like to quickly follow up on Todd's rent question. I heard you say that street rents were flat year-over-year in Q1 as you were looking to drive occupancy. What was the year-over-year change in street rents in April? Just trying to get a sense for how that's changing heading into the spring leasing season.

Spencer Kirk - *Extra Space Storage Inc. - CEO*

Okay, Christy, it's Spencer. Good morning. I'm not really happy to comment about what's going on in April. Let me clarify. Last fall we held street rates in the off season to gain occupancy. For the first quarter, on average it was 2%, and as we exited the quarter it was about 3%. So it's trending up, and we like the direction.

Christy McElroy - *CitiGroup - Analyst*

Okay. And on existing customer rents, you said that you're increasing rents on existing customers at about the same pace. I assume that's about 8% to 10%. I know that it fluctuates based on the length of stay but do you expect any change in 2014 in the percentage of your portfolio on which you're sending out rental rate increases?

Spencer Kirk - *Extra Space Storage Inc. - CEO*

No, that 8% to 10% range, Christy, is an average. It depends on the customer. It depends on how highly occupied a unit might be. It depends on seasonality. Depends how long the customer may have been in that unit. It could be less than that or it could be more, but I would say for 2014, modeling purposes, 8% to 10%.

Christy McElroy - *CitiGroup - Analyst*

But, I guess the question is, 8% to 10% on what percentage of your portfolio? So will it be the same number of tenants that you're giving a rental rate increase to?

Spencer Kirk - *Extra Space Storage Inc. - CEO*

Yes, no change.

Christy McElroy - *CitiGroup - Analyst*

Okay. And just lastly, if I think about the 6% to 7% same store rental growth projection for the year you're at almost 8% in Q1. How do you expect that growth rate to trend through the year? I know that you manage for revenue growth and you don't really disclose what the inputs are. You have your own internal forecast for what occupancy would be and growth and realized trends. I'm wondering if you could share those with us? In the first quarter if you're at about a 200 basis point occupancy delta and almost 5% realized rent growth. What should those metrics look like for the full year?

Spencer Kirk - *Extra Space Storage Inc. - CEO*

For the full year on occupancy, we're expecting that to trend towards 1% by the end of the year, so on average between 1% and 2%. We expect street rates, we just experienced obviously 2% average for the first quarter, so two to 3% by the end of the first quarter, pushing them during the busy season, during our summer months. And then see how they hold in the fall. Obviously, there is some risk if we don't find that we have as many rentals and if we have a drop off in occupancy, but we're expecting to push rates in the summer. In addition to that, the other thing that is actually causing our rental growth to slow towards the end of the year is the fact that our discounts have been down ten plus percent since last June. So we're coming up against some tough comps starting in June. So we're expecting our rental growth to slow as a result of the decrease in discount slowing.

Christy McElroy - *CitiGroup - Analyst*

So when you say rental growth I understand the slowing occupancy delta, but if I'm thinking about the realized rent growth are you talking about that slowing, as well?

Spencer Kirk - *Extra Space Storage Inc. - CEO*

What happened is last year, our discounts started decreasing to the tune of double digits, and that benefited our rental revenue growth by just around 1%. We expect that to be a smaller component of our rental growth this year, and that diminishing throughout the year. So at the start of the year, it was still in the 1% range, by the end of the year it's tough to continue to decrease your discounts ten plus percent, year-over-year.

Christy McElroy - *CitiGroup - Analyst*

So is that 4.5% to 5% range growth in realized rents per square foot is that sustainable going through the year as even as you have discounts decreasing?

Spencer Kirk - *Extra Space Storage Inc. - CEO*

If you take an average, let's say street rates on average are going to be 4%, your discounts are going to be half a percent. And your occupancy is going to be 1% to 2%. That's how you get that 6% to 7% range because we're expecting street rates on average for the year to be maybe 4% if we're lucky 5%. It's going to depend a little bit on how much pricing power we have during the busy season.

Christy McElroy - *CitiGroup - Analyst*

Thanks.

Spencer Kirk - *Extra Space Storage Inc. - CEO*

It's really kind of 2% discount, call it 4% street rates, and the rest coming from discount.

Christy McElroy - *CitiGroup - Analyst*

Thank you.

Spencer Kirk - *Extra Space Storage Inc. - CEO*

Thanks, Christy.

Operator

Our next question comes from the line of David Toti, with Cantor Fitzgerald.

David Toti - *Cantor Fitzgerald - Analyst*

Good morning.

Spencer Kirk - *Extra Space Storage Inc. - CEO*

Hi, David.

David Toti - *Cantor Fitzgerald - Analyst*

I won't make the Facts of Life joke again on this call, but I wanted to talk a little bit about transactions. You're obviously running pretty close to your full-year guidance, so I can assume the volumes are expected to slow down in the second half?

Spencer Kirk - *Extra Space Storage Inc. - CEO*

Where we are today, David, we closed on about $200 million right at the start of the year and the first 15 days. That transaction had been under contract from the end of last year. Right now, we're estimating to have about $350 million done by the end of June and right now we really only have the four properties under contract for just under $40 million. What we're saying is if we do $150 million of one off transactions for the last six months of this year, we think that that's attainable, and we think that that's actually good for our shareholders. If we come across a portfolio or something obviously that's going to benefit us and we could do more.

David Toti - *Cantor Fitzgerald - Analyst*

Are you able to disclose aggregate CAP rates on the acquisitions completed so far?

Scott Stubbs - *Extra Space Storage Inc. - EVP, CFO*

I can talk a little bit to that. Our CAP rates have been as low as zero, and I know that sounds odd. What I mean by that is we've done two certificate of occupancy deals in the first quarter of the year. And then on our stabilized or operating properties they're between 6% and 7%.

David Toti - *Cantor Fitzgerald - Analyst*

Okay. And then just if I can just tack one more question on. Some of our industry contacts have been commenting recently they're seeing notable compression in secondary tertiary markets but relative stability in the institutional quality REIT product. Would you say that's true based on what you're seeing so far year-to-date in terms of deals that have been coming across your desk?

Spencer Kirk - *Extra Space Storage Inc. - CEO*

David, it's Spencer. I would say notable compression might be a little strong. I think there's always the seller expectation of benchmarking or tagging their property to the core market transact ional rate. But as we've been showing through disciplined acquisitions, that you can still transact in that range of 6% to 7%, and I think that a lot of sellers hope to get a better rate, but are not necessarily achieving what they want. I think notable is probably a little stronger than I would have characterized it. There's a little bit but it's not substantive, is how I would say it.

David Toti - *Cantor Fitzgerald - Analyst*

Thanks for the detail today.

Spencer Kirk - *Extra Space Storage Inc. - CEO*

Thanks.

Operator

Our next question comes from Andrew Rosivach, with Goldman Sachs. Please, proceed.

Andrew Rosivach - *Goldman Sachs - Analyst*

Hi guys I'll tell you my goal with this question and ask it. I'm trying to figure out how an EXR same store may be a little bit different from the same store portfolio that hasn't been making a lot of acquisitions. And you had the big jump in the first quarter for the tenant reinsurance running through your same store. I'm curious, how much of that is like a truly stabilized asset getting a better rate and a better penetration versus is some of it assets that you bought in 2011 or 2012, that have entered the same store pool but really hadn't had the full tenant insurance penetration rate yet?

Scott Stubbs - *Extra Space Storage Inc. - EVP, CFO*

Our growth in tenant insurance is really coming from two or three components. One is as we increase the penetration it's going to help us. Let's say you go from 67% to 70%, that's going to grow by 3%. The properties we acquire help it a little but the majority of our growth this year has come from increasing the dollars per policy, so we have tried to make sure our tenants are adequately insured, and that is increasing the dollars per policy.

Andrew Rosivach - *Goldman Sachs - Analyst*

Got it. That helps, Scott. Thanks.

Scott Stubbs - *Extra Space Storage Inc. - EVP, CFO*

Thank you.

Operator

Our next question comes from Brandon Chisholm, with SunTrust. Please, proceed.

Brandon Chisholm - *SunTrust - Analyst*

Hi. Thanks for taking my question. Just real quick on the snow removal for same store NOI, if you normalize that what would same store NOI have been? And then on the same vein, were there lower move outs in the first quarter year-over-year?

Scott Stubbs - *Extra Space Storage Inc. - EVP, CFO*

Yeah, our NOI, if you would have just normalized the snow and utilities would have been 10.4%. The one thing I would caution you on that is we did have the benefit of lower payroll and lower property taxes in the quarter that kind of offset that. So, if you're going to normalize one you might want to normal lies both, so just to get to a normal run rate.

Spencer Kirk - *Extra Space Storage Inc. - CEO*

Brandon, to answer your question of move outs, obviously with the severe weather, move ins might have been a little bit muted. If you continue move in you probably can't move out, either .

Brandon Chisholm - *SunTrust - Analyst*

I guess you would say that they may have offset one another?

Scott Stubbs - *Extra Space Storage Inc. - EVP, CFO*

Yes. So if move ins to move outs we would say offset each other as far as the benefit or the detriment to same store NOI. Obviously, it affected it, but again we did have the benefit of property tax appeals going in our favor in the quarter, also.

Brandon Chisholm - *SunTrust - Analyst*

That's it for me. Thank you.

Scott Stubbs - *Extra Space Storage Inc. - EVP, CFO*

Thank you.

Operator

Our next question comes from the line of Vikram Malitouhortia, with more began Stanley. Please proceed.

Vikram Malitouhortia - *Morgan Stanley - Analyst*

Hi, guys. The last 12 or 18 months all the acquisitions you've done and where you've had the opportunity to overlay your own revenue management system. Can you maybe just talk about how rental was maybe 6, 12 months ago for those properties and maybe what you've seen as you've implemented or utilized more of your own system to overlay on those properties?

Scott Stubbs - *Extra Space Storage Inc. - EVP, CFO*

Yes. I would tell you that it really runs a pretty wide range. We've seen as much as 15%, 20% growth on some of those properties. We saw that on some Cincinnati assets a year and a half, two years ago. We've also seen as little as, similar to our same store growth, 5% to 7%. What I mean by that, there's a pretty big range of operators out there. Some of the properties we're buying are very well run, others maybe are a little bit antiquated in some of their methods. We bought some properties where they don't take credit cards, some that don't take cash. It really runs a range of anywhere probably between 5% - 7%, and 15% - 20%.

Vikram Malitouhortia - *Morgan Stanley - Analyst*

Okay. Thanks, guys.

Operator

Our next question comes from the line of Ross Nussbaum, with UBS. Please, proceed.

Ross Nussbaum - *UBS - Analyst*

Good morning. First of all, I do appreciate the added color on what the impact of the same store pool was from shifting it, but I guess maybe a question, or a comment, on that. Do you think it might make sense to revisit the definition of the same store pool insofar as a property that hits 80% occupancy, maybe that was stabilized in the old storage era, but these days it seems to be a little light and it seems like those properties are coming into the pool a little early and possibly influencing the number.

Scott Stubbs - *Extra Space Storage Inc. - EVP, CFO*

I would tell you it's something I think we'll consider going forward. I think if you asked anyone if 90% was going to be the new norm as far as stabilized occupancy, I don't think any one of us would see that. You also obviously have the risk of new development coming in. If self storage yields remain where they are I think you're going to see some new construction. Right now there's really no new construction. I think we've run into that. That risk is out there.

Spencer Kirk - *Extra Space Storage Inc. - CEO*

Ross, it's Spencer. If I could just add another comment, the definition that served us really well for the past decade, through the best of an economy and through the worst of an economy, and the idea of changing it is obviously something we need to evaluate, but there is still a lot of uncertainty and we don't know what the future holds and to work to effectuate change on something that has worked so well, we just need to study that before we act.

Ross Nussbaum - *UBS - Analyst*

Sure. I'm just throwing it out there. Obviously trying to get the quarter compared to last quarter is virtually impossible.

Scott Stubbs - *Extra Space Storage Inc. - EVP, CFO*

Understood.

Ross Nussbaum - *UBS - Analyst*

Okay. So my question, though, is I just want to clarify a comment made earlier and then push on it a little bit. Spencer, when you talked about street rates being up, I think you said 2%, and then trending to 3%, that comment was sequentially relative to where the street rates were towards the end of last year?

Scott Stubbs - *Extra Space Storage Inc. - EVP, CFO*

That's year-over-year, is what it is, Ross. And your other thing I think we have to be careful on anytime we're talking about rate growth is not to get too hung up on where we are just on street rates. I think we also need to consider where we are with discounts and that type of thing also.

Ross Nussbaum - *UBS - Analyst*

Totally with you. Sort of a net rent concept.

Scott Stubbs - *Extra Space Storage Inc. - EVP, CFO*

Correct.

Ross Nussbaum - *UBS - Analyst*

You think two, trending to 3% in March your sense is that number goes to 4% hopefully and maybe even a touch above it as we get into the summer?

Scott Stubbs - *Extra Space Storage Inc. - EVP, CFO*

We hope it goes, you know, 4% to 8%. We'll see what kind of strength we have in the summer . It's too early to tell.

Ross Nussbaum - *UBS - Analyst*

Is there anything that you're seeing today, it's already April, I know this was touched on, the biggest question I get towards the self storage industry is just the complete and total lack of visibility as to what pricing power is going to be two months from now. So what can you tell this audience as to what you're feeling today versus perhaps what you were feeling last in April 29, 2013, with respect to pricing power this coming summer?

Spencer Kirk - *Extra Space Storage Inc. - CEO*

Right. Without commenting about April, I can tell you year-over-year sentiment and year-over-year opinion, I'm equally optimistic. I'm buoyant, there are two factors, and I didn't want to bring them up but I'm going to bring them up. There is still virtually no new supply. Number two, because of the power and the potency of our internet platform we're taking market share from the smaller guy and that has not changed in 12 months and I don't see it changing in the next 12 months.

Ross Nussbaum - *UBS - Analyst*

Thank you.

Spencer Kirk - *Extra Space Storage Inc. - CEO*

Thanks, Ross.

Operator

Our next question comes from the line of Todd Stender, with Wells Fargo. Please, proceed.

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

Scott you've grown the size of the portfolio pretty quickly over the last couple years. Just haven't tapped a strait unsecured debt market. I just wanted to see if I can get an update on how you're going to structure the balance sheet, and maybe your aspirations to tap the bond market and potentially achieve an investment grade rating.

Spencer Kirk - *Extra Space Storage Inc. - CEO*

It's something we continue to look at. We're still stuck a little bit with covenants. We want to try to be as covenant light as possible. If you go standard investment rate, standard bond offering, there are certain standard covenants that come with that. So, it's something that we're considering. I think our Company is at a different state than we were five years ago. I think clearly our leverage is in line, and we're not looking necessarily to do a transformational transaction that makes us a rated entity tomorrow but it's something obviously that we're moving towards.

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

Okay. Thanks. And just a follow up with that, your cash balances according to the new guidance are expected to double. I just want to see what was behind that and is it really fair to assume you're using more internally generated cash flow when you're making your acquisitions and maybe less a need for equity?

Spencer Kirk - *Extra Space Storage Inc. - CEO*

It's a combination of a few things. One is more internal generated cash flow. Two is the timing. Some of the acquisitions have bumped back and the loans have not necessarily bumped back so it's a combination of those three things.

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

Thank you.

Operator

Our next question comes from Paul Adornato , BMO Capital Markets.

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Paul Adornato - *BMO Capital Markets - Analyst*

My question relates to industry consolidation. Just trying to get a sense of where we stand today, thinking about the universe of investment grade or property that you and the other public peers might be willing to own. And so given that there has been very little construction over five years, and you guys have continued to acquire and grow your managed pools, was wondering if you could compare industry consolidation then to now.

Spencer Kirk - *Extra Space Storage Inc. - CEO*

Okay. I don't have all the exact numbers, Paul. What I can tell you is the public companies own or operate about the same percentage that they did 15 years ago. I think as we look forward to the next five years it's probably a fair assumption to say with muted supply, and with recognition that the world has changed and it's not about yellow pages and drive up, but it's about the internet and drive up, I think it's likely that you will see some continued operational consolidation, as well as financial consolidation.

The advantageous cap rates that are out there today I think are causing a lot of people to say if I don't sell now, when would I sell? And we continue to see opportunities out there, and our transact ional history over the last eight or 12 quarters shows that the market is out there, and you can transact. If you use the number of 54,000 self storage facilities in the U.S., and you say that half of those are not institutional grade, that takes you down to 27,000. If you take the top several dozen operators owning or controlling about 7,000, to my way of thinking there might be about 20,000 facilities out there that would fit the profile of saying yes, this would be a nice inclusion into an institutional portfolio. So a lot of stuff out there. We're never going to get to. But I still think the market is wide open for a lot of consolidation either operationally or financially.

Paul Adornato - *BMO Capital Markets - Analyst*

Okay. Thanks. I just didn't catch maybe the beginning part of your comments when you said that compared to five years ago, that the public operators own or managed about the same percentage. Given that there was a lot of growth in your guy's portfolios and very little new construction.

Spencer Kirk - *Extra Space Storage Inc. - CEO*

Okay. My comment was for 15 years ago. I don't know where we were five years ago, Paul. But I can tell you from 2003 to 2007, there were about 13,000 self storage facilities built in the United States, which put us over the 50,000 mark. So we could go back and reconstruct that. I'm just speaking anecdotally from some loose data points, but generally the public companies have owned or operated about the same percentage historically. It hasn't changed a lot.

Paul Adornato - *BMO Capital Markets - Analyst*

Okay. Great. Thank you.

Operator

Our next question comes from Paula Poskon, with Robert W. Baird & Company. Please,proceed.

Paula Poskon - *Robert W. Baird & Company, Inc. - Analyst*

Thanks. Good morning, everyone. I want to follow up on the transaction commentary. Spencer your comments that the historically cap rates are attracting what were perhaps previously reluctant sellers. Are you hearing that from your JV partners, as well? Clearly, some of those relationships have been in place a long time. What's their propensity for recycling their capital?

Spencer Kirk - *Extra Space Storage Inc. - CEO*

It depends on the partner. It depends on the fund, whether it's open or closed. And the investment objectives. I can tell you many of our partners have reported that year after year after year self storage has been their best performing asset class. And if they got out of storage they don't know where they would redeploy the capital to get the same kind of return, that same mentality exists with many of our third party managed owners. Some of them are first generation, thinking about retiring or passing along wealth to their posterity, others are saying why would I want to sell? I don't know where to redeploy my cash, where I would get the same kind of return that I'm getting out of storage. It all depends on the individual, it depends on the fund, it depends on the portfolio manager, and that is a very broad swath because about 500 of our assets that say Extra Space fall under that partially owned or non-owned category.

Paula Poskon - *Robert W. Baird & Company, Inc. - Analyst*

And the acquisitions that you closed on in the first quarter and have under contract, were any of those from your JV or third party relationships or were those off marketed deals that relationships came to you in other ways or were those marketed deals?

Spencer Kirk - *Extra Space Storage Inc. - CEO*

Two of those properties came from joint ventures or ones that were related managed entities. The rest were all outside third parties.

Paula Poskon - *Robert W. Baird & Company, Inc. - Analyst*

Thanks. That's helpful. That's all I have.

Operator

Our next question comes from Michael Salinksky, with RBC Capital Markets. Please, proceed.

Michael Salinsky - *RBC Capital Markets - Analyst*

Good morning, guys. Just to go back to the portfolio question. Can you talk about just looking at market deals, what's the quality on the market? I know it appears it was mentioned that quality is down a little bit. And then just to go back to the street rate question, since you guys pushed occupancy more so in the first quarter and then drive on rate, what do you think street rates were up for the industry in the first quarter?

Scott Stubbs - *Extra Space Storage Inc. - EVP, CFO*

This is Scott. I can comment a little bit on street rates. It's a little bit difficult to comment on what we see as an industry. We compare our properties to their three closest competitors and we don't necessarily move resulting on what they do. We've seen them zero to 5%. It really depends on the property and the competitor.

Spencer Kirk - *Extra Space Storage Inc. - CEO*

Then on the transact ional stuff, Mike, many of our competitors/peers as I have even said, there are some lower quality portfolios coming to market. Maybe as a percentage, the lower quality stuff has ticked up. It does not mean that there aren't decent portfolios that are out there to be had, and there is plenty of maneuvering room on acquisitions as you think there might be 20,000 self storage facilities that are still out there that don't have one of the brand names of the 4 REITs flying the flag over that asset. So for us, yes, there's been a down tick in quality but it doesn't mean that there aren't good opportunities, solid opportunities, and decent assets to be had. You just make have to work a little harder, be a little more selective and be a little more disciplined.

Michael Salinsky - *RBC Capital Markets - Analyst*

Then this is my follow up question. You talked about not seeing any new supply right now nationwide. Are there any markets that you're starting to see a noticeable creep up in the last 60 to 90 days in terms of new construction? And then also just as you have many joint venture partners and you're looking at various things, have you seen any relaxation in terms of lending on new construction among the small regional banks?

Scott Stubbs - *Extra Space Storage Inc. - EVP, CFO*

So as far as new supply in the last 60 to 90 days I can't tell you a market that has seen significant new supplier tick up there. As far as the banks lending, I think it's still fairly difficult. We have not seen them lax. I think with the regulation, I think the banks are still more than willing to lend to people that have money. So if someone is well capitalized I think it's pretty easy to get money. That doesn't mean development loans aren't out there. I think people can get development loans, it's usually through relationships or local banks.

Michael Salinsky - *RBC Capital Markets - Analyst*

Okay. Thank you much.

Operator

Our next question comes from the line of Dave Bragg, with Green Street Advisors. Please, proceed.

Dave Bragg - *Green Street Advisors - Analyst*

Thank you, good morning. Spencer, last quarter you commented on the potential for a disconnect between buyer and seller expectations, and you attributed it in part to your higher cost of capital, and earlier in this call you seem to suggest the same type of relationships. So we would love to hear you elaborate on that particularly in light of your much improved cost of capital.

Spencer Kirk - *Extra Space Storage Inc. - CEO*

My statement I think I could summarize it this way, Dave. When I talk about a disconnect, if I could be very specific, many folks think that a 5 CAP or a sub 5 CAP is the going rate for the going rate and the best markets. Think Manhattan. Brand-new property. The smaller operator, perhaps with the property that's a little bit older in a secondary or tertiary market uses that five benchmark and says well maybe my asset could be worth 5 1/2 or six CAP. And once again it all comes back to how Extra Space scores the quality of an asset. And this works for us, I'm not suggesting it's for anybody else that's a storage operator but for Extra Space our philosophy is simply this. We look at the quality of the market, we look at the quality of the physical asset, and we look at the quality of the location of that physical asset within the market. And we make a determination as to what we think that that asset will be worth.

And many times there is a disconnect between our view of the world and what the seller might expect and that's where I think it's fair for me to say Extra Space is interested in transacting but not at any cost, not for any price point. But for a price point that simply is accretive for our shareholders. And we're working harder to find the acquisitions that fit our operational footprint and fit that quality scoring. And with that, we'll see what happens. Our cost of capital moves up and down, Dave. It depends on a lot of factors , but the bottom line for us is we want to be disciplined and do accretive acquisitions.

Dave Bragg - *Green Street Advisors - Analyst*

That's helpful. Thanks for that. And directionally as your cost of capital has improved, is there potential for that disconnect to narrow?

Scott Stubbs - *Extra Space Storage Inc. - EVP, CFO*

I think that what we saw was when the cost of capital got more expensive the pricing didn't change a lot and now that it's back down I'm not sure it will change that much either. It's possible it's just a point in time. You saw interest rates pick up for a period of time. They're not necessarily down, the growth has slowed but I think everybody would agree that interest rates are going up.

Spencer Kirk - *Extra Space Storage Inc. - CEO*

We don't want to get whip sawed, Dave, with the changes and the fluctuations that take place over a short period. We're taking long view on our weighted average cost of capital. And we're looking at what the market is going to do. There are a lot of aberrational elements that pop in and out of the equation, and we don't want to react or over react to any of those. We want to be consistent and sustainable in our actions.

Dave Bragg - *Green Street Advisors - Analyst*

Thank you. One final question related to acquisitions. And as it relates to underwriting, what we understand is every deal or portfolio deal is very different, but from a broad perspective, over the last couple years, how have you adjusted your NOI growth underwriting for, say, years two through five of the deal, as the cycle has matured, and you get slightly closer to the rival of new supply?

Scott Stubbs - *Extra Space Storage Inc. - EVP, CFO*

Our underwriting, we typically base it on how our properties in the area are doing, and we have not necessarily made an adjustment or an assumption that new supply has or will come to affect that property.

Dave Bragg - *Green Street Advisors - Analyst*

Okay. So no change?

Scott Stubbs - *Extra Space Storage Inc. - EVP, CFO*

No change.

Dave Bragg - *Green Street Advisors - Analyst*

Thank you.

Scott Stubbs - *Extra Space Storage Inc. - EVP, CFO*

Thanks, Dave.

Operator

(Operator Instructions). Our next question comes from the line of Tayo Okusanya, with Jefferies. Please, proceed.

Tayo Okusanya - *Jefferies & Company - Analyst*

Good afternoon. Great results for the quarter. Most of my questions are around acquisitions. The deals that you guys announced this quarter, just wanted to clarify that the stabilized assets were bought at a 6-7 CAP rate, and there is still some asset that's are technically a zero cap rate?

Scott Stubbs - *Extra Space Storage Inc. - EVP, CFO*

That is correct. When we say 6-7, that's a year one forward-looking cap rate and some are absolutely at CLO.

Tayo Okusanya - *Jefferies & Company - Analyst*

Is the 6-7 for the entire portfolio or just the stuff excluding the CLO stuff?

Scott Stubbs - *Extra Space Storage Inc. - EVP, CFO*

Just for the stuff excluding the CLO stuff.

Tayo Okusanya - *Jefferies & Company - Analyst*

And what kind of NOI growth are you using for that first 12 months I guess the six to seven cap?

Scott Stubbs - *Extra Space Storage Inc. - EVP, CFO*

It is anywhere between 5% and 9% on year one. Well actually 5% and 8%.

Tayo Okusanya - *Jefferies & Company - Analyst*

Okay. That's helpful. Then the second thing, again, you now have about $350 million of acquisitions locked and your guidance is $500 million. Just kind of curious if you guys see a good chance of exceeding guidance given how well you've done year-to-date on what your situation pipeline looks like?

Spencer Kirk - *Extra Space Storage Inc. - CEO*

What I would say is let's go back and put a little perspective in this. Just right after the year began, we closed on the Virginia portfolio of $200 million in assets. That really was an activity that largely took place in 2013. And where we draw this artificial line of December 31st and January 1st and put something in one year or the following year, I wouldn't get too hung up on that. I would say a lot of what happens in our acquisitions guidance is predicated on knowing what we think we can do versus what potentially might happen. And all it takes is a joint venture partner to come to us and say hey, we're thinking about liquidating these asset, would you be interested in buying them. Or it just takes someone to say, you know what,it's time for me as an owner to sell my portfolio. And that's really hard to script. So we look at what we know, we know what the historical velocity has been and we give you our best prognostication. We certainly could do considerably better, but I don't have any basis and we don't have any basis for making that statement, because we haven't had any substantive dialogue with any owner either off market or open market to substantiate that, so we have given you our best guidance and our best guess.

Tayo Okusanya - *Jefferies & Company - Analyst*

That's helpful. Just one more. With occupancy now breaking 90%, when we start thinking about an upper limit for that number where you kind of have structural vacancy you can't get rid of, would you guide us in regards to how we should be thinking about that? How much more that occupancy rate could go up?

Spencer Kirk - *Extra Space Storage Inc. - CEO*

Let me tell you the way I view the world. We think that just with about 6% to 7% of your properties, either vacating 6% to 7% of the total units or renting 6% to 7% of the total units each and every month, you kind of stay somewhere around 94% is a good place to start to think. And if you're at 94% occupancy, I can tell you if that's an average, you have a lot of size codes that are sold out, which is something we don't like to do. We think you're leaving money on the table at that point. Because if you're sold out in some of the more popular sizes codes some of the less desirable units are not at that 94%, they're in the mid 80s or high 80s. So, for us we could drift up a bit, during the absolute peak of the season, but to expect to get much above 94%, 95% I don't think is reality and I don't think that that's somewhere where we think we're going to be operating. Certainly our revenue managing system with the predictive inputs that it has to drive the algorithm is going to not let us get to those levels. Now as we learn and see what the market shapes up to be, things could change but today I would say low to mid 90s is the limit for Extra Space.

Tayo Okusanya - *Jefferies & Company - Analyst*

Got it. And then lastly, just one more, from a development perspective, when you just kind of take a look at market pricing right now, at what point does development start to make sense again? Are we still a year away, two years away from that?

Spencer Kirk - *Extra Space Storage Inc. - CEO*

Well, I would like to give you my seven part thesis on why I don't see development coming anytime in the future but I'll give you a truncated version. Number one, banks are reluctant to lend. Two, there is an awful lot of interest in the prime parcels from every asset class, which is driving up land prices. If banks aren't willing to lend or the lending terms are less favorable there's a ding to the profitability. If you're paying more for land that's a ding to the profitability. If you're the mom and pop developer or the local developer and you can't compete on the internet you're going to have to sign up and have someone who can provide the flow of customers to your property, and you're going to be paying a management fee, you're going to be sharing some if not all of the tenant insurance and you're going to be getting hit with some down stream costs for call center and other marketing expenses. That's your third ding on the profitability. And I just think that the return versus the risk equation has shifted, and people are a little bit more reluctant. There is ample interest in doing development, but when you really see the number of properties that are coming out of the ground, it is still muted and I don't see those fundamental elements either on having to sign up a management company and paying a fee, or property prices being pressured upward, or banks willing to lend to the smaller perhaps under capitalized individual. I think those are ding's that will remain in place for the foreseeable future. There will be some building, but I don't see anything that's going to put a lot of new supply into the market in the near-term at all.

Tayo Okusanya - *Jefferies & Company - Analyst*

Thank you very much. Good color.

Spencer Kirk - *Extra Space Storage Inc. - CEO*

Thank you.

Operator

We do have a follow up question from the line of Todd Thomas, at KeyBanc Capital markets. Please proceed.

Todd Thomas - *KeyBanc Capital Markets - Analyst*

Couple quick follow ups. First, Scott, you mentioned in response to an earlier question on tenant insurance you've increased the dollar amount per policy or that's where some of the growth has come from. Can you just provide more detail on what you're doing with regard to insurance program?

Scott Stubbs - *Extra Space Storage Inc. - EVP, CFO*

Our tenants are insured based on the dollar amount of the goods that they have stored. And what we found is we want to make sure that our tenants have adequate coverage. So as we are offering tenant insurance, we are making sure that they are truly valuing their goods at the correct amount, and we are basically executing better at the point the rental is made and having them take the correct amount of insurance which is effectively pushing it up. So for instance instead of them insuring $2,000 worth of goods they're now insuring $3,000 worth of goods.

Todd Thomas - *KeyBanc Capital Markets - Analyst*

Okay. And can you quantify what the monthly dollar amount per renter is in terms of the insurance collections that you're receiving?

Scott Stubbs - *Extra Space Storage Inc. - EVP, CFO*

I don't have it in front of me per renter.

Todd Thomas - *KeyBanc Capital Markets - Analyst*

Okay. What about the overall penetration rate within the EXR portfolio today?

Scott Stubbs - *Extra Space Storage Inc. - EVP, CFO*

Over all it's around 70% depending if you're looking at mature or overall portfolio.

Todd Thomas - *KeyBanc Capital Markets - Analyst*

Okay. And a question on page 21, in the supplement where you break out the joint ventures, you've been in the promote for two of the JVs for some time. I was just wondering if you could talk about whether you're getting close to any of those other promote hurdles that are in the high single digits for some of the larger joint ventures at all.

Scott Stubbs - *Extra Space Storage Inc. - EVP, CFO*

On the larger ones we are not. Those promotes actually had slight escalations that took effect at the same tame we were going through a recession. We have some catch up to do on those and we're not near the promote on any of these Storage USA, Legacy JV's, the big ones there.

Todd Thomas - *KeyBanc Capital Markets - Analyst*

Okay. All right. Great. Thank you.

Scott Stubbs - *Extra Space Storage Inc. - EVP, CFO*

Great. Thanks, Todd.

Operator

We have another follow up question from the line of Brandon Chisholm, with SunTrust.

Unidentified Participant - *SunTrust - Analyst*

This is actually Keegan. Just one follow up. What happens to a property when there's a new development next door? I'm sure you have a lot of historical data. Could you talk a little bit about financial impact, whether it be occupancy or rents, that typically happens when there's a new supply moving in next door?

Spencer Kirk - *Extra Space Storage Inc. - CEO*

Okay. There are a lot of variables on that, Keegan. I would say the biggest impact is what is the population density and how many other self storage facilities are already in the market. So if you're in southern California, in Venice, and you got 500,000 people in a three-mile radius, and they're already 20 self storage facilities serving that population, if you add one property, it's a 5% increase in supply, and it's not going to really have material effect. If you're in Wichita, Kansas, and there are two games in town in a three-mile range, it can have a pretty detrimental affect which is why most of the REITs want to be in the better more densely populated markets. It's your protection against the downside.

Unidentified Participant - *SunTrust - Analyst*

Okay. A related question. How much redevelopment potential do you have in your existing properties in terms of expansion entitlement that's have not been used yet, to try and get a sense of if you guys did pursue incremental development or redevelopment what the existing potential could be just in your properties alone today?

Spencer Kirk - *Extra Space Storage Inc. - CEO*

Okay. We are redeveloping our assets, we have been looking at how to keep them relevant in the marketplace, by bringing them up to the current standards. In terms of a bunch of properties that have a lot of expansion capability and a lot of vacant parcels next to it, it's not a lot. What we want to do is just make sure that the assets that we have appeal to the customer and regardless of when new development arrives into this market we have an asset that is competitive, it's well located, it's well cared for, it's clean, and it meets the customer's needs and that means you might be adding some climate control to the property, you might be knocking down the office and reconstructing a more retail oriented higher visibility office. So this redevelopment effort is something that we have fully engaged in, and it's all towards keeping the properties relevant. But in terms of adding lots of square footage because we're sitting on a bunch of vacant land, not so much.

Unidentified Participant - *SunTrust - Analyst*

Okay. Thank you.

Spencer Kirk - *Extra Space Storage Inc. - CEO*

Thank you.

Operator

We have another follow up question from the line of Todd Thomas, of KeyBanc Capital Markets.

Jordan Sadler - *KeyBanc Capital Markets - Analyst*

Hay, it's Jordan Sadler. I wanted to quickly touch on the tax expense. Obviously, the tenant reinsurance business is a good and growing business for you guys, and as is that tax liability, so you're obviously making money. Is there another way to shelter some of that liability at this point given the scale of that TRS at that point?

Scott Stubbs - *Extra Space Storage Inc. - EVP, CFO*

It's something we're looking at all the time. There is some risk. We want to make sure we go about it properly. I think probably there is an opportunity to argue that tenant insurance is standard and customary to the point where you could move it into the REIT but that's a long process with the IRS but it's something we're always looking at.

Jordan Sadler - *KeyBanc Capital Markets - Analyst*

Okay. So potentially it is clean income? Like a rental income stream? Sort of an ancillary fee associated with owning the facility?

Scott Stubbs - *Extra Space Storage Inc. - EVP, CFO*

We would need to prove it's customary and standard in the business.

Jordan Sadler - *KeyBanc Capital Markets - Analyst*

Makes sense to me. And then separately on the commercial segment of the business, not a lot of discussion. Are you seeing anything different in the commercial segment of the business relative to your individual renters? Are you seeing more traction, less traction, anything? Any commentary would be helpful.

Spencer Kirk - *Extra Space Storage Inc. - CEO*

Okay, Jordan. It's Spencer. Here's what I'll tell you. I'm just coming up on 16 years in self storage. When I started, about 20% of the customers were commercial accounts. Today, it's about 20%. It hasn't changed a lot, and I don't expect it to materially shift over the next for seeable period. So for us, it's out there. It's a part of our business. We like it. They tend to be on auto pay. They tend to be less sensitive to rate increases. But in terms of wholesale shift in driving our commercial accounts to 30%, or 40%, or 50%, market demand just isn't there and it's been remarkably consistent for the 16 years that I've been in storage.

Jordan Sadler - *KeyBanc Capital Markets - Analyst*

Okay. Thank you.

Spencer Kirk - *Extra Space Storage Inc. - CEO*

With that, I would like to thank everybody for their interest in Extra Space. We'll look forward to next quarter's call. Have a good day.

Operator

Ladies and gentlemen thank you for your participation in today's call. This concludes the presentation. You may now disconnect. Have a wonderful day.