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EXR - Q2 2013 Extra Space Storage Inc. Earnings Conference Call

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PRESENTATION

Operator

Good day, ladies and gentlemen and welcome to the second quarter 2013 Extra Space Storage earnings conference call. My name is Derek, and I will be your operator for today. At this time all participants are in a listen-only mode. We shall facilitate a question-and-answer session at the end of the conference.

(Operator Instructions)

As a reminder this conference is being recorded for replay purposes. I would now like to turn the conference over to Mr. Clint Halverson, Vice President Investor Relations. Please proceed.

Clint Halverson - *Extra Space Storage Inc. - VP - IR*

Thank you, Derek. Welcome, everyone to Extra Space Storage's second quarter 2013 conference call. In addition to our press release we furnished unaudited supplemental financial information that you can access 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 SEC filings which we encourage our listeners to review. Forward-looking statements represent management's estimates as of today, Friday, August 2, 2013. The Company assumes no obligation to revise or up of date 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, Chief Executive Officer.

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

Thanks, Clint. Hello, everyone. Q2 was another excellent quarter for Extra Space. Fundamentals remain strong and while there has been an increased interest in new construction we have yet to see any significant new supply in the markets in which we are located. Our technology platform, advanced revenue management system, internet prowess and unique operating structure have again produced outstanding FFO growth. FFO was up 32% over the same quarter last year and we were able to increase our dividend by 60%. Our disciplined and creative approach to sourcing and executing on acquisitions that enhance shareholder value has been validated. During the quarter we placed two portfolios located in core markets under contract for over $300 million. These transactions are a great representation of the value in building and cultivating mutually beneficial relationships. Now I would like to turn the time over to Karl.

Karl Haas - *Extra Space Storage Inc. - EVP, COO*

Thanks, Spence. During the first quarter we had same-store revenue growth of 7.8%. That was on top of 6.7% we realized in the second quarter last year. Rentals and vacates are within historical norms. Our square foot occupancy remained at record high levels ending the quarter at 90.8%. That's up 1.8% over last year. Street rates were up 3% to 4% for the quarter.

Discounts to new customers during the quarter were down 12%, and the percentage of new customers receiving a discount was down over 10% year-over-year. We saw expenses shift towards the norm. Increases were due to growth in payroll, insurance, and repairs and maintenance expense. Net operating income for the quarter was 10.4%. This is notable when you consider that net operating income was up 10.2% in the second quarter last year. Higher rates, lower discounts, stable rental demand, and high occupancies continue to support record high performance. With that I would like to turn it over to Scott.

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

Thanks, Karl. Last night we reported FFO of $0.50 per share. This is $0.01 above the high end of our guidance. This can be attributed to better than expected same-store property and tenant insurance results.

During the quarter we purchased four assets for approximately $48 million located in Hawaii, Maryland, and Texas. Subsequent to the end of the quarter we closed on two additional properties for approximately $9 million, located in Arizona. Year to date we have closed on just over $70 million in acquisitions. As of today we have an additional 37 assets under contract for just over $300 million. 20 of these assets, located throughout northern and southern California, are from the previously announced OP unit transaction for $206 million. The remaining 17 assets are located in 7 states. We anticipate that these acquisitions will close by early in the fourth quarter.

During the quarter we continued to evolve our balance sheet and executed a $250 million exchangeable bond offering. This unsecured financing fits well with our commitment to increase our financial flexibility. Based on our acquisition activity, our new debt estimates, and our operational performance we have updated our full-year 2013 FFO guidance to be between $1.96 and $2.01 per share. We expect FFO for the third quarter to be between $0.49 and $0.51. These estimates include noncash interest expense and acquisition-related costs. When you adjust for these items, FFO is estimated to be between $2.01 and $2.06 for the full year and between $0.51 and $0.53 for the third quarter. With that I will now turn the time back to Spencer.

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

Thanks Scott. Our results show that we have the platform, the properties, and the people to propel our performance. Same-store results were strong, but more importantly we had another outstanding quarter in FFO growth because of the multiple components or levers that we use to drive profitability. The operating environment remains positive, and we remain focused in our efforts to optimize occupancy, maximize revenue and minimize expenses. We believe we will continue to produce double-digit FFO growth for the foreseeable future. Let's turn the time over to Clint to start our Q&A session.

Clint Halverson - *Extra Space Storage Inc. - VP - IR*

Thank you, Spencer. In order to ensure we have adequate time to address everyone's questions, as in the past, I would remind everyone to keep your initial questions brief and if possible limited to two. If time allows we will address follow-on questions once everyone has had an opportunity to ask their initial questions. With that, we will turn it over to Derek to start our Q&A session.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Todd Thomas, KeyBanc Capital Markets.

Todd Thomas - *KeyBanc Capital Markets - Analyst*

Hi, good morning. I'm on with Jordan Sadler as well. First question, in terms of acquisitions, it looks like acquisition activity overall appears to be ramping up a bit, and I was just wondering longer term, I know the business is scalable, so adding property to the platform makes sense, but I would just be curious to hear your thoughts about the Company's appetite to invest today.

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

Todd and Jordan this is Spencer. We are seeing a large volume of acquisitions coming to the market. Mainly in smaller one-off transactions. It's interesting to note that seller expectations are incredibly high. Might even be characterized in some cases as ridiculous. So for Extra Space we want to participate where it makes sense, we want to remain disciplined and make sure that what we do adds value for our shareholders.

Todd Thomas - *KeyBanc Capital Markets - Analyst*

Okay. It's been a few quarters since anything has really surfaced from within the joint venture portfolio. Are you having any discussions with your partners there? Any indication that there could be some opportunity there in the near term?

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

What I can say about the JV relationships, we've got 279 properties in JV relationships. We do have discussions. We give annual reports to our partners, if not quarterly reports in some cases, and, of course, we're wanting to engage in the dialogue, but we don't want to be too eager, because that's going to drive up the price and be counterproductive. And so as I have said in the past what we want to do is be a great partner, and when our partner decides that it's time to monetize their assets, we're ready, willing, and able to transact, and hopefully we will be able to do something that is a win-win situation for both parties.

Todd Thomas - *KeyBanc Capital Markets - Analyst*

Okay. And then if I could just sneak one in for Scott, I was just curious about the thought process behind the exchangeable notes offering, maybe relative to a more traditional five-year off banked financing. I was just wondering, in terms of the pricing also, I think it got priced a little bit outside of the range that you were initially targeting, 1.5% to 2% or so. Just curious if you received any feedback, maybe wondering why it priced where it did relative to your initial expectations.

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

I think the initial expectations we went in with were probably more relevant to the market as it had been maybe two weeks or a month prior to that. The market was pretty choppy the week before, and then the follow-on, the month after. So we went in probably as bit more optimistic than maybe we should have been. We feel like we priced a deal that was very beneficial to the Company. It's a 2.375 deal with a 30% up as far as the exchange feature. We feel like it is going to be a good option for our shareholders. One of the largest benefits for us is it is unsecured, so it frees up a large group of properties and enables our balance sheet to just become that much stronger because you have fewer properties tied to loans.

Todd Thomas - *KeyBanc Capital Markets - Analyst*

Okay. Thank you.

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

Thanks, Todd.

Operator

David Toti, Cantor Fitzgerald.

David Toti - *Cantor Fitzgerald - Analyst*

Hey, guys, good morning. Spencer, question for you. You talked about sort of positive fundamentals. If we think about the rapidly growing supply/demand imbalance, assuming that the macro backdrop stays more or less the same, what does '14 look like to you relative to industry fundamentals, pricing power, and could the supply outlook change relatively quickly next year given these kind of conditions?

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

Lots of questions in there, David. 2014, I remain optimistic for a few reasons. First is, like the other operator, large operators, the publicly traded companies, it appears that we're all kind of in record territory in occupancy. That bodes well for perhaps pushing street rates and minimizing discounts.

The new supply question is one that there's a lot of talk, there's lot of chatter, there's perhaps even some activity, but to get a self-storage property located in a great location is not a six-month deal. It's a multi year deal to get the entitlements and permits and everything to allow to you build where you are in a retail corridor rather than at the end of some cul-de-sac in some industrial park. So with one-year construction time frame on top of that and a lease up period of two to four years, I still maintain to the best of my ability to prognosticate that in 2014 there will not be meaningful competition from the new supply chain. It just takes too long to bring properties to market and have a broad impact.

Last and final point. If you look at the natural population increase, plus immigration, the country is growing at about 1% a year, about 3 million people. You would need to have on order of 500 to 550 new self-storage properties per year coming into the market to just keep pace with what the population is doing. And so to our way of thinking, 2014, we've got strong Internet presence, limited new supply, record occupancies and I see no reason why 2014 won't be a good year for all of the larger operators.

David Toti - *Cantor Fitzgerald - Analyst*

Okay, thanks. Then my second question, just has to do more with technology and retail. If we think about your sort of technology advantage, the success you've had with the reinsurance product, what could Extra Space do by way of additional retail delivery given a relatively massive and captive business to consumer channel? Have you guys explored potentially expanding the sort of secondary kind of high-margin retail product delivery?

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

We have, David. We've done that for 15 years. I'm sure other operators have done it for more than 30 years. And what we have learned, if I could be really direct, customers want five things from a self-storage provider. They don't want prepaid phone cards, they don't want cell phones, they don't want car washes and convenience stores bolted to the side of a self-storage facility. They want something that is conveniently located to their home, it's clean, it's secure, you've got someone competent and courteous behind the counter, and it's a competitive price. You can't be out of bounds. You deliver on those five elements and customers are happy. Focus group after focus group has just said deliver on these five things and we'll store with you. You start missing or getting distracted, we're going to look somewhere else.

David Toti - *Cantor Fitzgerald - Analyst*

Okay, that's helpful. Thanks for the detail today.

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

No problem.

Clint Halverson - *Extra Space Storage Inc. - VP - IR*

Thanks, David.

Operator

Christine McElroy, UBS.

Christine McElroy - *UBS - Analyst*

Hey, good morning, guys. You have been talking for some time about a second-half slowdown in revenue growth, and your guidance certainly implies that. Do you still expect your toughest comp to be occupancy? And just from a strategic standpoint, does Public Storage's report last night of a 95% occupancy level give you some encouragement of potentially achieving those levels as well, or do you think that you will ever try to manage your portfolio to that high of an occupancy level?

Karl Haas - *Extra Space Storage Inc. - EVP, COO*

Christy, never is a long time. So we -- I never thought -- this is Karl, but I never thought that we'd see any operator operating at 95%. Public does a lot of things very well, and it seems to be working for them. I don't anticipate us going to 95%, but I would say that as they get to those levels and continue to do well, that it makes us think that we might be able to push what we see, or what we have previously thought of as our highest level, that we might have some more up side. But our revenue management system really we put a lot of stuff, a lot of different metrics in there. It's based on a whole lot of different metrics, the competitor's prices, our occupancy, occupancy by type, and everything else, and it spits out what our pricing should be and it balances out the occupancy with the rate and the discount to get to what we think is the right answer. So we very well could go higher, but it's -- right now it's not -- we're not anticipating getting to 95% anytime soon.

Christine McElroy - *UBS - Analyst*

And, Karl, just looking at the acceleration in your realized rent growth from last quarter, can you talk about the biggest impacts to that number going from 3.3% in Q1 to 4.9% in Q2, and maybe quantify the drivers. I don't know if I missed those. I think I heard you say the discounts were down 12% but if you could also say what street rents were year-over-year and where you're pushing in place customers.

Karl Haas - *Extra Space Storage Inc. - EVP, COO*

The components, or what we call the waterfall, is 2% from occupancy growth, 3% from street rate, 1% from the delta in the ECRI or existing customer rates, and 1% from the reduction in discounting.

Christine McElroy - *UBS - Analyst*

Okay, that's helpful. And what were your street rents year-over-year?

Karl Haas - *Extra Space Storage Inc. - EVP, COO*

They were up about 3% to 4%.

Christine McElroy - *UBS - Analyst*

3% to 4%, and just one last question.

Karl Haas - *Extra Space Storage Inc. - EVP, COO*

But keep in mind, that's the actual street rate. That gets supplemented with the reduced discounting that really helps to drive the overall growth.

Christine McElroy - *UBS - Analyst*

And did you mention -- I know you've disclosed this in past quarters -- the impact on same-store revenue growth of the newly added properties for this year?

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

It's about 80 basis points.

Karl Haas - *Extra Space Storage Inc. - EVP, COO*

It's been running like 0.8% to 1%.

Christine McElroy - *UBS - Analyst*

Okay. Thank you.

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

Thanks, Christy.

Karl Haas - *Extra Space Storage Inc. - EVP, COO*

Thanks.

Operator

Michael Knott, Green Street Advisors.

Michael Knott - *Green Street Advisors - Analyst*

Hey, guys. Karl, just a follow-up on that. I'm curious how, if I heard you right, the revenue growth impact from street rate increases was 3 to 1 compared to the existing customer increases. Is that an atypical relationship? Is that new?

Karl Haas - *Extra Space Storage Inc. - EVP, COO*

No. This is pretty consistent with what we've been seeing.

Michael Knott - *Green Street Advisors - Analyst*

Okay. Because I was under the impression that street rents were not really strong enough to drive revenue growth, so as customers moved out and new customers moved in, I thought most of the rent growth was coming from existing customers.

Karl Haas - *Extra Space Storage Inc. - EVP, COO*

Well, you've got to keep in mind that what we're talking about is delta year-over-year. And when -- our ECRI, we've been aggressive on ECRI all the way for the last six or seven, maybe longer than that, eight years. So while it is a big driver of our revenue growth, and it does increase what existing customers are paying, the delta in what we're doing as far as increases has not gone up that dramatically. Does that clarify?

Michael Knott - *Green Street Advisors - Analyst*

Yes, that helps, thanks.

Karl Haas - *Extra Space Storage Inc. - EVP, COO*

Okay.

Michael Knott - *Green Street Advisors - Analyst*

And then, Spencer, I'm just curious if you can talk about Ken Woolley stepping down as CIO and what impact do you think that may or may not have on your Company's ability to continue to grow externally and just what sort of the long-term plan for that role in terms of CIO. Thanks.

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

It's really simple, Michael. Ken is a very talented man. He's been doing storage for 36 years. With Ken's intellect, he obviously also has a broad and diverse set of business interests. The change, the transition I believe is going to allow Ken to focus on some of those outside interests while still being actively engaged in the growth and strategy of Extra Space. If you think about where Ken can add value, he's got a lot of vision, and he's very creative, and I think those ideas will help propel innovation here at Extra Space. But realistically, the greatest contribution Ken can offer this Company is being in a role where he taps into those long-term relationships and utilizes the personal selling and the personal connection that he can make to drive transactions in the off market so that Extra Space is able to have meaningful growth without having to overpay for assets. And I think if you look at what's going on right now in one of the two portfolios that we announced, Ken had a very strong and pronounced role in bringing that to a successful conclusion, and that's the role that I envision Ken as executive chairman. Someone helping with strategy and someone helping to leverage relationships so that we can continue to grow in a meaningful and accretive way.

Karl Haas - *Extra Space Storage Inc. - EVP, COO*

Michael, this is Karl. I would like to add, too that where Ken brings value on my side of the business is that he is very -- he's a guy that stays at 30,000 feet and helps with -- and we don't need much of it. Eight hours a month of him talking to our revenue managers and challenging what they're doing and he can talk at their level but also bring that practical experience to it, and even with me, with operations, and -- Ken -- we don't need a lot of Ken's time, but he is just incredibly valuable with being able to come in, understand things quickly, and help kind of tweak the direction. And we'll continue to get that for as long as we want it and need it.

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

I think, Michael, the answer is, he left for Russia four-and-a-half years ago. He's been back just a little over a year, and I think having settled back into his particular stage in life and what the stage that Extra Space is in today, we have found the right balance for the future. It's working very, very well.

Michael Knott - *Green Street Advisors - Analyst*

Thank you.

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

Thanks, Michael.

Operator

Ki Bin Kim, SunTrust.

Ki Bin Kim - *SunTrust Robinson Humphrey - Analyst*

Thank you. Did you guys quote a cap rate on some of the pending deals that you have yet to close?

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

It's Spencer. It's kind of in the 6% to 7% range.

Ki Bin Kim - *SunTrust Robinson Humphrey - Analyst*

Okay, is that the range going in or stabilized?

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

It's forward looking.

Ki Bin Kim - *SunTrust Robinson Humphrey - Analyst*

Okay. Could you comment on maybe the couple other big portfolios out there in the market? I know you guys said some forward expectations are seeming crazy, and when you -- could you maybe comment on maybe the Morningstar portfolio, what you think that quality of that portfolio is compared to your Company's and where you think pricing would come in at that, for that property.

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

First of all, I didn't use the word crazy. I used ridiculous.

Ki Bin Kim - *SunTrust Robinson Humphrey - Analyst*

Okay.

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

Separate and distinctly, with regards to Morningstar, the only observations that I would make, three-fold. Number one, we bid. Number two, we weren't invited back for round two. And number three, we didn't think it was the best operational overlay for our existing footprint. We think there might be better portfolios in terms of where we're conducting business, and for us I would simply say I don't know where it's going to come in ultimately on pricing, but we're out, and we're comfortable with it.

Ki Bin Kim - *SunTrust Robinson Humphrey - Analyst*

Would you be willing to state maybe where you guys bid, where you didn't get invited back for round two?

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

I'm not going to tell you specifically but I will tell you we were in the lower quartile.

Ki Bin Kim - *SunTrust Robinson Humphrey - Analyst*

Okay. And just last question on your expenses. It seems like property taxes are going up for a lot of these other real estate sectors. Your expenses haven't really moved up that much. Is it something that we can -- I guess what should we expect going forward longer term?

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

We would tell you it's probably similar to inflation, 3% to 4%. That's what we continue to budget. We've been able to manage that and we hope it continues to come in in the 1% to 2% where it is coming in, but our expectation is more in the 3% to 4%.

Ki Bin Kim - *SunTrust Robinson Humphrey - Analyst*

Okay. Thank you, guys.

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

Thanks.

Operator

Michael Salinsky, RBC Capital Markets.

Michael Salinsky - *RBC Capital Markets - Analyst*

Good morning guys, or actually, good afternoon, East Coast time. Spencer you talked about 2014 not being a problem from a supply standpoint, but as you look out to 2015 given starts, does that appear a challenge?

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

I don't know yet, Michael. My crystal ball doesn't go out that far. We'll have to wait and see what's going on. There could be significant new supply, and per chance maybe the economy starts to heal and gets the momentum. So how it plays out, I'd probably be a fool to speculate on 2015. All I can say is, for the foreseeable future, we're optimistic that the fundamentals are strong, demand is strong, the larger operators are taking market share from the smaller operators, and we're in a good position.

Michael Salinsky - *RBC Capital Markets - Analyst*

That's helpful. Second, Karl, can you talk about the acceleration in street rate growth throughout the quarter and also kind of where you're tracking in July?

Karl Haas - *Extra Space Storage Inc. - EVP, COO*

I wish I could tell you that I had some control over it, or that it stays consistent, but we're up and down every day. Based on what the model tells us, and so there was really no specific trend up. I will say that -- and I guess we anticipate the question, I might as well answer it now, July was a very good month. We held firm, and we're pleased with where July came in.

Michael Salinsky - *RBC Capital Markets - Analyst*

Okay. And, Spencer, bigger picture question, and using your term ridiculous, how would you define ridiculous maybe in terms of where assets are trading versus replacement cost? How big does that delta have to get before you would look at development as another one of the growth engines, just given where market pricing is today?

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

Ridiculous to me is relative, and I'm only speaking from the Extra Space perspective. We have a certain business model, Michael. And we want a certain spread on transactions, so that we are doing accretive deals. And I'm not talking accretive in years four and five. Everybody's business model is different. So when I use ridiculous it's only from the very narrow perspective of Extra Space. Obviously in A-markets with A-quality assets, you can justify very low cap rates. But as you start to get into secondary and tertiary markets with properties that are maybe 10, 15 years of age, we have a tough time wrapping our arms around the arithmetic that makes sense for Extra Space.

So for us, I would say looking down the road for development -- well, just one other comment on purchasing. We don't look at replacement costs as the primary thing. We look at the cash flow, and we're primarily a cap rate buyer. So as you think about development and where the spread becomes large enough, I have made the statement a number of times, Extra Space is out of the development business. I don't see us getting back into the development business. It doesn't make sense for this organization.

Now, the caveat. There might be an occasional property or a joint venture partner that brings considerable other resources to the table where we might enter into a JV program. We have nothing to announce today. I don't know of anything that's contemplated. But we can't preclude that with some other structure we might be willing to enter the game. We shut down the development department and this Company has no plans to open one up and restaff.

Michael Salinsky - *RBC Capital Markets - Analyst*

Thank you much.

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

Thank you.

Clint Halverson - *Extra Space Storage Inc. - VP - IR*

Thanks, Mike.

Operator

Paula Poskon, Robert W. Baird.

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

Thanks. Good afternoon, everyone. Spence what are you seeing from the third-party inbound calls? Are you continuing to see that at an accelerating pace and are you accepting more of those, turning away more of those? What's happening in that business?

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

There has been an acceleration. I think there's a gradual awakening, Paula, between the have's and the have not's, and the internet is the great divider, not the great equalizer. I think our friend Dave Rogers said that folks aren't scared yet, but I think there's a growing awareness that there are capabilities with scale and size that the smaller folks cannot replicate. So we are getting more inbounds calls, but I will tell you way more than 50% of the calls coming in are getting rejected, because either the market is not right, the asset is too small, or the asset quality is not appropriate for this Company. And so we are selective. We're growing nicely. But quite frankly, I don't think we're growing as quickly as I would like us to, but we're not going to lower our standards to meet our actions.

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

Fair enough. Are you seeing any changes in terms of your commercial customers? Is that on the up tick as the economy continues to improve?

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

No, what's really interesting, Paula, I've been doing this for over 15 years and the ratio between commercial and residential with very minor fluctuations has remained the same.

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

Great. Thanks very much.

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

Thanks, Paula.

Operator

Todd Stender, Wells Fargo.

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

Good morning, everybody. On the All Aboard acquisition, can you share what some of the details of that portfolio was just in terms of the rent per square foot, how that kind of compared to your current portfolio in those California markets, and maybe what the strategy is to get the occupancy up, which I think is in the mid-70s% range.

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

Without getting into too many details on the rent per square foot, we would tell that you that 12 of the assets are in Southern California, 8 are in Northern. Very good overlay with our existing assets. And we would tell you we are going to manage them very similar to the way we manage our existing ones, using the same internet and pricing strategy that we do at our existing.

Karl Haas - *Extra Space Storage Inc. - EVP, COO*

This is Karl. I think we also see some opportunities with our strategy of having multi-tiered pricing, more clear-cut multi-tiered pricing, and combined with the discounting that we see as an opportunity. Their pricing wasn't that bad, but we think there's some tweaks and some of the things we've been doing for awhile that makes us feel like many of their properties are very close to our properties, and our properties are substantially more occupied than theirs. So we think that we have, just through kind of tweaking what they were doing, we should be able to see some really good growth in occupancy.

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

Thanks, Karl. Just at the margin, if I could stick with you, just with the expansion opportunities, are they in general smaller facilities, or anything that you like about the size or the possibilities to expand them?

Karl Haas - *Extra Space Storage Inc. - EVP, COO*

Well, they're not overly large. They're decent size. Most of them are single story in markets that -- I don't think we'll be doing it in the short run, but I think in the long run, these properties are in markets where you could go up. And so we also see in the long run some potential. They're in such great markets that we probably will have the ability sometime in the next 3 to 5 to 10 years to take some parts of these properties out and go up.

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

And that starts to bring in the conversation of climate control and adding to that?

Karl Haas - *Extra Space Storage Inc. - EVP, COO*

Well, in California, climate control is not such a big thing. So it is not going to be so much climate control, but we probably -- if we build up, we probably would do climate control, but you don't get a big premium, especially Southern California, Northern California, for climate control.

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

Okay, thank you.

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

Thanks, Todd.

Operator

Caitlin Burrows, Goldman Sachs.

Caitlin Burrows - *Goldman Sachs - Analyst*

On the topic of large acquisitions being in the market, can you just comment on the mix of properties you're seeing, whether there are many portfolios versus one-off properties? Hi Caitlin, it's Spencer. Once again, we see a large volume of acquisitions continuing to come to the market but primarily it's the smaller one-off transactions. The fact that there have been so few larger transactions, and the only one that I'm aware of that's kind of hanging out there currently is Morningstar. Speaks to the fact that larger portfolios are hard to build. With the performance of self storage, a lot of people are happy holding what they've got so I think it's going to be the smaller one-off transactions primarily in the future. That makes sense. If you do see portfolio acquisitions, do you look at them differently and have different requirements and hurdle rates when they are that much larger?

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

A little bit. We think that there's some benefit to picking up 20 or 30 assets at a whack, or 40 assets, especially when the operational footprint is a nice overlay. So there is a premium we'll put on a portfolio, but we as a Company want to be careful in not placing too much of a premium on the ease and simplicity of getting a bunch of assets in one transaction. This Company has an acquisitions team that is geared up and ready to go and do a number of smaller transactions and hitting those singles has worked well plus the occasional double or triple or even homer. But I think it just boils down to we're ready to conduct business on whatever scale.

Caitlin Burrows - *Goldman Sachs - Analyst*

Got it. Thanks.

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

Thank you.

Operator

R.J. Milligan, Raymond James & Associates.

R.J. Milligan - *Raymond James & Associates - Analyst*

Hey, guys, most of my questions have been answered. I was just curious if you could tell us what the occupancy was at the end of July.

Karl Haas - *Extra Space Storage Inc. - EVP, COO*

Yes, we can. It is -- was around 91.5%.

R.J. Milligan - *Raymond James & Associates - Analyst*

Great. Thanks, guys.

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

Thanks, R.J.

Operator

Quentin Velleley, Citigroup.

Michael Bilerman - *Citigroup - Analyst*

Hi, it's Michael Bilerman. Spence, as you think about your comment about size and scale and the public landlords, where do you think over the last 12 to 24 months the operational differential has been between sort of public and the entirety of the sector? How much market share, put aside acquisitions, but how much market share do you think has been taken at the occupancy level, the rate level public versus private? Michael, I don't have the exact numbers on top of my head. I can just say I look at the data supplied by Reese and SSDS and others and say, build larger, more sophisticated operators. By the way, some of those are private. There are some larger regional guys that are doing very well. But as you look at our occupancies versus their occupancies, our NOI versus their NOI, it's pronounced. And I can only anecdotally tell you two stories that I have firsthand knowledge, because I asked the question, but I become really concerned, not for me but for them when I'm talking to an existing operator and they tell me that their NOI is 10% or more below where it was in 2008. And the storm has long since passed, and the larger operators are putting up record results and record occupancy. And I think the advantage is not going to abate anytime soon. And so going back to your ridiculous comment how much do you think sellers are trying to get credit for that differential of being able to sell their portfolio or their assets into one of the public landlords that have that size and scale that can drive so much better efficiencies and occupancy? How much, is that the tension that's happen where sellers are effectively trying to be greedy?

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

I won't say they're trying to be greedy. I'll say they're trying to optimize what they have. When they see a notable transaction in the New York metro in the 5 cap rate, and perhaps they live in Wichita, Kansas and think, well, I won't get a 5, but I can get a 5.5 or a 6 because I'm not New York based. I think they're just trying to optimize what they hold and maximize their value, and I don't fault them in any way, shape or form. The question is, what is reasonable and rationale, and what is defensible, and every company that's out there buying properties has to answer that for themselves.

Michael Bilerman - *Citigroup - Analyst*

And then just lastly, just on the $350 million that closed and under contract in terms of the acquisitions, you had mentioned 6% to 7% cap rate. Can you share with us sort of what is the going in cap rate on those assets and when do you reach a 6%? When do you reach a 7%? It was just a pretty wide range and I just want to understand the dynamics of these assets coming on line day one versus sort of a forward yield.

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

You guys are wearing me out. I'm going to have Scott answer this one.

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

Yes, I would tell you it's typically within a year to a year and a half that we're at those cap rates. So we're bringing up the occupancy and stabilizing the rents to rents similar to what we have. None of these portfolios have -- they're not 50% occupied or anything of the sort. We're basically optimizing what is out there today.

Michael Bilerman - *Citigroup - Analyst*

Right. So where does it start, and when -- what's the going in? In the third quarter or the fourth quarter, we're going to bring in $350 million of assets. Should we bring those in at a 4 cap? Should we bring those in at a 5 cap? How should we think about going in yield versus getting to a 6% or 7%?

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

Your going in yield might be slightly below a 6%, and so it's not a significant discount. And then we underwrite fairly conservative going to potentially 6.5% or 7%.

Michael Bilerman - *Citigroup - Analyst*

Over 12 months.

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

12 to 18 months, correct.

Michael Bilerman - *Citigroup - Analyst*

Okay, thank you.

Operator

Todd Thomas, Keybanc Capital Markets.

Jordan Sadler - *KeyBanc Capital Markets - Analyst*

Hey, it's Jordan Sadler. Just on acquisitions you mentioned that the only portfolio you're aware of was the Morningstar one. Does that mean you did not look at the $375 million or so that PSA is expecting it to close on this quarter?

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

Jordan, it's Spencer. I don't know what portfolio that is that has been referenced.

Jordan Sadler - *KeyBanc Capital Markets - Analyst*

21 in Florida, 5 in Mass, 2 in California, 1 in Rhode Island. And it could be one-offs, who knows. I don't know if it's a portfolio at all. Doesn't sound like Morningstar.

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

It probably isn't Morningstar. It could be another portfolio, but -- and we're aware of some that have been talked about being carved up. So when you ask me to comment on that, I can till we've looked at some other stuff, but not necessarily in totality.

Jordan Sadler - *KeyBanc Capital Markets - Analyst*

Okay. That's fair. Ultimately the word that will define this call will end up being, with hindsight, it'll be ridiculous, of course. In all the years you haven't been one to be prone for hyperbole so I am interested in sort of following up on your comment there a little bit which is, any thoughts on selling assets at ridiculous levels?

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

Yes, I actually had a discussion with someone last week. We were trying to buy their assets, and they said that they would be a buyer at a 4 cap. So if anybody wants to offer Extra Space a 4 cap, yes, I would be interested in selling. But right now, Jordan, we are building a Company, we're building value for the long term, and dismantling this Company is not something that I am interested in.

Jordan Sadler - *KeyBanc Capital Markets - Analyst*

Not dismantling, but are there properties around the edges worth pruning?

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

Absolutely. A few here or a few there. But it is going to be maybe a dozen or two dozen, and that to me is 5% of the portfolio, and what we have to look at is, what is the loan structure, what is the ownership structure, and it becomes a little bit complicated, and at the end of the day those properties that are fully unencumbered, or perhaps we have 100% control on, I can count on one hand where we say we have the ability to maneuver.

Jordan Sadler - *KeyBanc Capital Markets - Analyst*

That's fair. Thank you for the color.

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

Thanks, Jordan.

Operator

Christy McElroy, UBS.

Ross Nussbaum - *UBS - Analyst*

Hey, it's Ross Nussbaum here with Christy. Two follow-ups. The first is, when Ken Woolley joined the Board of American Homes for Rent, which is an entity controlled by Public Storage's chairman, was that something he discussed, Spencer, with you or the Board, and how did you guys feel about that?

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

He discussed it, and I was fully aware of it. The Board was aware of it, and we're fine with it. Once again, Ken, like many other chairman, sits on other boards. And I don't think that that's problematic in a public company setting.

Ross Nussbaum - *UBS - Analyst*

Okay. But nobody found it peculiar that it's a board controlled by the chairman of your largest competitor?

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

It's peculiar, but it's not unpalatable or unreasonable, given how small the audience is. The fact is Ken used to work for Wayne Hughes. They've had a wonderful friendship for 30 years. They're both brilliant minds, and I think Wayne was looking for a way to bring some intellectual horsepower to his new company. I think Wayne was smart and I think it's been a good thing for Ken.

Ross Nussbaum - *UBS - Analyst*

Okay. Second question. Fundamentally, Michael Knott asked a question earlier in the call, and he was expressing some surprise that rent growth from existing customers wasn't as big a driver as I guess rent growth from street rents. And I guess I shared that surprise, because I thought you guys were raising rents in existing customers by, call it 8% plus. So I guess maybe the question here is, what percentage of your existing customers are actually getting that, staying around long enough to get that increase? I guess I'm not understanding why that's not a bigger driver.

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

Okay. So I'm going to flip this back over to Karl. But the issue is, let's verify what you've said. Yes, we're getting more than 8%, and it's about 45,000 to 50,000 customers a month that get the rate increase. But we've been in that range for a long, long time, Ross, of the 7% to 8%. So you're not going to get a ton of juice out of that in more stable environment.

Karl Haas - *Extra Space Storage Inc. - EVP, COO*

Ross, this is Karl. The thing is, if we stop giving increases to our existing customers, we would have a very significant drop in our growth. But as long as what we're doing is just consistent year after year after year and people leave, people come in, but we're giving basically about the same number of increases, and the same percentage, the growth -- it's not going to be a big year-over-year increase in the delta, and then that's what I was saying. What we were talking about was the waterfall.

Ross Nussbaum - *UBS - Analyst*

It's the second derivative is flat is kind of what you're saying.

Karl Haas - *Extra Space Storage Inc. - EVP, COO*

Yes, if I understand what you're saying.

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

That is correct.

Ross Nussbaum - *UBS - Analyst*

Okay. Maybe we all misunderstood that original comment. That makes sense. Just finally, where are your average in place rents relative to your street or maybe, on a net basis, net of concessions? Is there a way -- any kind?

Karl Haas - *Extra Space Storage Inc. - EVP, COO*

This is Karl. We've been saying that for the last, about the last year. It's basically flat. They're on top of each other.

Ross Nussbaum - *UBS - Analyst*

Thanks, guys.

Operator

Michael Knott, Green Street Advisors.

Michael Knott - *Green Street Advisors - Analyst*

Hey, guys. All the way back in your supplemental on page 25 you show some details on your joint ventures, and you have a column that shows whether you're in the promote or not. There's a couple that are. I'm just curious if there's some hidden value in some promotes that just haven't been realized that no one is giving you credit for. Just curious why maybe we haven't seen more of these be in the money on the promote, just given how strong the operating environment has been. Does it require a recapitalization of some sort?

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

Yes, Michael this is Scott. The majority of those that are not in the promote actually were from the Storage USA acquisition. If you think about what happened from the time the Storage USA acquisition happened until today, you actually add downturn where those properties effectively went backwards. So some estimates were put in place, and the agreement was put in place with the assumption that it was going to go up from that point, obviously. And with the downturn, it's possible we eventually get into the promote, but we're not near it right now. And that's for about half of the joint ventures on that page.

Michael Knott - *Green Street Advisors - Analyst*

Okay. And then if I have done the math right I think you have about $375 million of acquisitions that have either closed this year or are under contract. So your bump in your guidance really isn't that much more than what you have already got accomplished. So I'm just curious, if that math is right, then does that mean that you are being just very conservative on what you expect to happen the rest of the year, or do you not think that there will be more opportunities?

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

First of all, I would tell you your math is correct, we're looking at this in terms of here we are the first of August and based on what we have under contract or what we're looking at, it generally takes 60 to 90 days to close on something. So realistically, based on what we have that we're looking at, what we've discussed in our real-estate committee, we feel like 24 million is a number we can do. We hope to exceed that.

Michael Knott - *Green Street Advisors - Analyst*

Okay. Sticking with acquisitions, just curious if there's any evaluation or grading of how the pipeline of acquisition opportunities through the third-party management is coming along, and is that paying off or is it more just the other benefits of that program that you would tout right now?

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

We continue to talk to the owners, and this year we bought two from a joint venture partner. One additional property out of that portfolio. We had one fall out of contract due to some other reasons. But we continue to farm that pipeline and hope to continue to close on acquisitions through that.

Michael Knott - *Green Street Advisors - Analyst*

And then just one more from me if I could and that would be on your tenant insurance. Just curious what's driving that growth of 16% in the same-store pool on the revenue side, because I would have thought your participation rate was already fairly high, and I don't sense that there's a lot of pricing power in that business, but it's been just -- just curious where that growth is coming from.

Karl Haas - *Extra Space Storage Inc. - EVP, COO*

This is Karl. What really presents a good opportunity is, as we bring in new properties, where there's almost no penetration, and then we're going from zero to 10% to 20% to the 60%-some, almost 70% that we get them to at maturity, that's, as you indicated earlier, the reason we are one of the primary drivers for the third-party management is that when you factor in tenant insurance, it is a good business for us. If you didn't have tenant insurance, it wouldn't be worth doing it, because while we are getting -- it is a good pipeline, and JVs, probably even better in the long run, we're not stealing properties. We're buying them. There aren't too many people that have these properties that are going to sell it to you without talking to other people or checking the market. While it does -- it gives us the ability to be kind of first in line, but we're not the only one in line when it comes to buying these properties, that's not the only reason we're doing it. A big part of it is the fact that we're adding to our platform, having more ability to spread our overhead, and tenant insurance, and we have had very, very good growth this year. I think in the first quarter we added 57 properties to our third-party management, and most of those come to us with very low insurance penetration.

Michael Knott - *Green Street Advisors - Analyst*

I get that the income statement shows big growth in that business because you are adding new properties, but on the same-store basis, I would have suspected that all those properties already had the programs in place.

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

Michael this is Scott. In our same-store pool, if you remember, we changed the same-store pool this year to include 15 properties in Cincinnati that had very low, if any, tenant insurance penetration, as well as 19 properties in Southern California as well as our -- the final development asset. So we added a fair number of properties that had lower tenant insurance penetration, so that obviously has helped increase the tenant insurance.

Michael Knott - *Green Street Advisors - Analyst*

Thank you.

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

Thanks, Michael.

Operator

Tayo Okusanya, Jefferies.

Tayo Okusanya - *Jefferies & Company - Analyst*

Good afternoon. Congrats on a solid quarter. Wanted to go back to the whole idea of acquisitions. Spencer, I know you said that apart from Morningstar you weren't aware of any other big portfolios out there. But I'm just curious. If you do take a look at your crystal ball and you project out 6 to 12 months, do you expect for us to see more portfolio deals with Morningstar just kind of being the first of many?

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

I think that's a reasonable assumption. Obviously with cap rates drifting down, as they have been, seller interest is peaking, and I think that's a very rational conclusion to come to, Tayo. There is going to be more, and the question is, how does the bidding take place and how does it fit into each company's respective financial modeling.

Tayo Okusanya - *Jefferies & Company - Analyst*

Okay. That's fair enough. Thank you for the insight as always.

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

Thanks, Tayo.

Operator

Ki Bin Kim, SunTrust.

Ki Bin Kim - *SunTrust Robinson Humphrey - Analyst*

Thanks. Couple quick follow-ups. If I understand your 100 basis point increase in your same-store NOI stems from rate increases of existing customers, that number, if I understand it correctly is 1%. Is that because as customers get rent increases that they couple them, and they eventually, when they do leave, the replacement customer is coming in at a street rate which is much lower, so that spread dynamic, unless your rates or rising dramatically, or the level of rate increase you're giving out are higher, that number, it's difficult for that number to move up over time. Is that correct?

Karl Haas - *Extra Space Storage Inc. - EVP, COO*

This is Karl. Probably.

Ki Bin Kim - *SunTrust Robinson Humphrey - Analyst*

Okay.

Karl Haas - *Extra Space Storage Inc. - EVP, COO*

You said there's a lot of pieces there, Ki Bin, and I know you're a deep thinker, and probably more -- you're kind of going beyond what I'm capable of explaining. But the bottom line is, it's just hard for it -- unless we change, unless we go from 8% on average increase to 9% or 10%, and -- or we have a tremendous increase in the number of people we're going to give increases to, that delta is just not going to increase that much. It is going to be relatively flat. So there's only two levers. It's the number of people you give the increases to, and the percentage increase, and the number of people we're giving it to is relatively consistent, and the percentage increase is staying relatively consistent. Unfortunately, we were aggressive, very aggressive to start with it on it, and have been for a couple of years, so it's not like we were doing 5% and now we're going to 6% or 7% to 8%. We've been at 8%, the range is 7% to 9%, for awhile. So I hope -- hopefully that answers this, but -- because it is what it is.

Ki Bin Kim - *SunTrust Robinson Humphrey - Analyst*

Right. I guess you kind of answered my second part of the question was, do you expect, as things get tighter, to change the level or frequency of the rate increases?

Karl Haas - *Extra Space Storage Inc. - EVP, COO*

I don't think we're going to change the frequency. If things get so, I hate to say this, but if we were at Public Storage's level of 95%, we might be looking at raising more because you could afford -- there is -- we say that overall it doesn't impact vacates, but at some point it does have some impact, and so unless you want to take the risk and increase vacates even more, you don't want to go past a certain point. So unless we change our -- unless we get to a totally different occupancy level, I don't see us being able to change the percentage increase.

Ki Bin Kim - *SunTrust Robinson Humphrey - Analyst*

And then just quickly, you said 45,000 customers a month get it. What does that translate into percent of portfolio, or percent of total customers?

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

About 7%.

Ki Bin Kim - *SunTrust Robinson Humphrey - Analyst*

7% a month?

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

Somewhere in there.

Ki Bin Kim - *SunTrust Robinson Humphrey - Analyst*

Okay. And last quick question, your same-store revenue on your managed assets have gone up pretty significantly better than your core portfolio's run rate. It's somewhat of a double edged sword, if you want to buy those assets, you make it more expensive on yourself, but maybe, have you guys thought about increasing the charge, the amount you charge to your partners or maybe adding a promote to those deals?

Karl Haas - *Extra Space Storage Inc. - EVP, COO*

We've looked at it. The thing about it, Ki Bin, it's commodity out there, management services to some degree, and you can't be too far out of what's considered market. So while we feel like we are going to do a better job managing these properties, we also need to be somewhat in the market.

Ki Bin Kim - *SunTrust Robinson Humphrey - Analyst*

Okay. Thank you guys.

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

Thank you.

Operator

At this time there are no further questions in queue. I would like to turn the conference back over to Mr. Spencer Kirk for any closing remarks.

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

we appreciate your interest in Extra Space today. We will look forward to next quarter's call. Thank you.

Operator

Ladies and gentlemen, that concludes today's conference. We thank you for your participation. You may now disconnect. Have a great weekend.