FINAL TRANSCRIPT

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EXR - Q3 2010 EXTRA SPACE STORAGE INC Earnings Conference Call

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CONFERENCE CALL PARTICIPANTS

Operator

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PRESENTATION

Operator

Greetings and welcome to the Extra Space Storage third quarter 2010 earnings conference call. At this time all participants are in a listen-only mode. A brief question and answer session will follow the formal presentation. (Operator Instructions) As a reminder this conference is being recorded. It's now my pleasure to introduce your host, Mr Clint Halverson. Thank you, Mr. Halverson, you may begin

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Clint Halverson - *EXTRA SPACE STORAGE INC - Senior Director, Investor Relations*

Thank you, LaTonya. Welcome to Extra Space Storage's third quarter 2010 conference call. In addition to our press release, we've also furnished unaudited supplemental financial information on our website. Please remember that management's prepared remarks and answers to your questions contain forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995 . Forward-looking statements address matters which are subject to risks and uncertainties that may cause actual results to differ from those discussed today.

Examples of forward-looking statements include those related to Extra Space Storage's development and acquisition program, revenues, and operating income, including FFO and guidance. We encourage all of our listeners to review a more detailed discussion related to these forward-looking statements contained in the Company's filings with the SEC. Forward-looking statements represent management's estimates as of today, Friday, October 29, 2010. Extra Space Storage assumes no obligation to update these forward-looking statements in the future because of changing market conditions or other circumstances. I would now like to turn the call over to Spencer Kirk, Chairman and Chief Executive Officer.

Spencer Kirk - *EXTRA SPACE STORAGE INC - Chairman & CEO*

Welcome. Thank you for joining us today. With me are Kent Christensen, our Chief Financial Officer, and Karl Haas, our Chief Operating Officer. We're pleased to announce another strong quarter. We exceeded the top end of our quarterly FFO guidance by $0.01. We experienced strong internal growth, a 3.9% same store revenue gain, a 3.1% same store expense decline resulting in a 7.8% same-store NOI growth. We had a productive quarter with respect to our external growth strategy. The early signs of improvement on the acquisitions front that we spoke of on our second-quarter call has turned out to be true. We purchased three properties sourced from our third party management platform in the quarter and we have purchased three additional properties since the end of the quarter. Our marketing efforts for the third party management program have provided meaningful acceleration. We added another 21 properties to the platform during the third quarter and one more since the end of the quarter.

We opened another state-of-the-art development in Hialeah, Florida and we anticipate completing an additional two to four sites by year end. We will complete the remainder of our development pipeline in 2011. We continue to make improvements to our balance sheet. Since the apex of the credit crisis our total debt is down 21%. This has increased our financial flexibility. And with just two months remaining in 2010, I believe that it is important to assess what we have accomplished year-to-date. We have driven internal growth and our pricing have stabilized. We have incrementally improved various programs to enhance our operational efficiencies and reduced our cost structure. We've created an infrastructure that has multiple levers to generate earnings growth. And we are proud of what we have accomplished. However, we are not satisfied and we will continue to use every effort to optimize our results. I would now like to turn the time over to Karl.

Karl Haas - *EXTRA SPACE STORAGE INC - COO*

Thanks Spence. During the quarter we achieved same-store net operating income growth around 7.8%, driven by both top-line growth and by improving operating efficiencies. Occupancy ended the quarter at 180 basis points compared to last year. 180 basis points above the prior year. With improved occupancy and similar pricing compared to the prior year, combined with decreases in bad debt and discounts, we achieved 3.9% same store revenue growth this quarter. While the market is still challenging, we are seeing rentals and vacates comparable to prior year's. We have experienced some softness in the pricing to new customers, but continue to have strong pricing power with existing customers. On the expense front, we benefited from a successful tax appeal in 2010 and improved operational efficiencies. We have continued to aggressively manage all expense categories, achieving a 2.6% reduction in controllable expenses.

An example of our operational efficiencies is in our customer delinquency mailings, where through a relatively simple modification we've reduced our expense almost 50%. Through focus on usage and reductions in retrofits, we are also seeing our utility expenses stay under control and expect to even have more savings as we get further into our retrofit programs. We continue to push on all our operational growth levers, but recognize that there are challenges that will likely make a recovery a moderate one. We will also maximize all opportunities and expect to produce the best possible results. In short, we will make the most of what the market offers. With that I'd like to turn it over to Kent.

Kent Christensen - *EXTRA SPACE STORAGE INC - CFO*

Thanks. Last night we reported FFO per share of $0.24, including $0.03 of development dilution and a $0.02 charge related to the writeoff of a long-term office lease with a subtenant that we assumed in the acquisition of Storage USA in 2005. The impact of these better than expected results, along with the sequential improvements in our business, has led us to increase our FFO guidance for 2010 to a range of $0.88-$0.89. This guidance includes a development dilution and the onetime office lease charge realized this quarter. The condition of our balance sheet continues to improve and recently we have seen more attractive debt pricing. This quarter we made progress by extending the maturity of our $50 million line of credit to 2013 and eliminating the floor on our Wells Fargo revolving line of credit. Overall our leverage year-over-year has improved, our net debt to EBITDA is 6.8 versus 7.8 a year ago and our total debt is down to $1.1 billion from $1.4 billion this time last year. We believe we have a solid foundation for continuing our growth.

We continue to grow our third party management business and have increased to a total of 157 properties under management. All properties currently under management are branded as Extra Space. This enables us to take full advantage of our national footprint and increase our brand awareness. Our third party management platform continues to demonstrate its value as a way for us to lever our operating platform and provide an acquisition pipeline. During the quarter we closed on three acquisitions totally $5.4 million, all sourced from our third party management platform. And subsequent to the end of the quarter we closed on an additional three properties for a total of $21.2 million. One of those was from our third party management business. In addition to closing these six acquisitions, we have five additional properties under contract that we expect to close by the end of the year. For the year we estimate that we will purchase 15 properties for approximately $65 million, of which seven have come through our third party management business. With that I'll turn the call back to Spencer. Thanks, Kent.

Spencer Kirk - *EXTRA SPACE STORAGE INC - Chairman & CEO*

We have had a strong rebound in our operations, but as I have said, it is possible that this rate of growth may not be sustainable. We see our economic recovery as a gradual moderately positive slope. And successfully navigating through the economic cycle of the last few years. I think. speaks will to the stability of self storage. We are pleased with the strong results of the past quarter and I give full credit to our team. We continue to use our advanced technology, sophisticated revenue, the revenue management tools, and our personal selling skills at the site to capture and maximize the value of every sale. In addition to a strong focus on the top-line, everyone at Extra Space is focused on minimizing every expense. Extra Space has demonstrated resilience in the downturn and we have laid the foundation for continued growth. The acquisitions environment is improving and we are making progress on our third party management business. Going forward, development dilution will diminish and we will begin to see a positive impact on FFO. Embedded gains from our development properties are forecast to be $0.25 over the next 3 to 4 years. We do look forward to the opportunities that lie ahead and with that said let's take some questions.

QUESTIONS AND ANSWERS

Operator

Thank you we will now conduct the question and answer session. (Operator Instructions) Our first question comes from Christy McElroy with UBS. Please proceed with your question

Christy McElroy - *UBS - Analyst*

Hi, good afternoon, everyone. With occupancy gains having been the biggest driver of your revenue growth in the last two quarters or so and with occupancy closer to more normalized levels at this point, what drives revenue growth from here? Do you still need to drive move-ins higher or is all that pushing rents and how do you do that in this economic environment?

Karl Haas - *EXTRA SPACE STORAGE INC - COO*

Well the other driver, this is Karl, Christy. The other driver all along has been our existing customer rate increases, which we've continued through thick and thin. So that certainly has helped to contribute. But we will, what we are hoping for and why we are a little bit cautious right now is that we will be able to see the existing or the street rates move in the right direction. And it's challenging, we are trying to hold occupancy and as a result we're being very aggressive on street rates and so we are not seeing a lot of growth from the prior year. So -- but we also have seen a decrease in discounting, because as we have gotten higher occupancy, the way our system works is certain unit types will kind of fall off the full month discount, some will go to no discount, some will go to half month discount. So we are hoping with a higher occupancy we will be able to make some gains as a result of lower discounting and also that we will see some firming up of street rates.

Christy McElroy - *UBS - Analyst*

So when does that, when does all that start to flow through to the net rent per occupied square foot number, because you are still sort of running flat year-over-year.

Karl Haas - *EXTRA SPACE STORAGE INC - COO*

When we see more of the stabilization of the street rates and able to push more. I mean the good news is there's no new competition coming on and we are seeing rentals are holding pretty close to prior-years. Now what we are hoping for is that we can see rentals start to grow over prior-years.

Christy McElroy - *UBS - Analyst*

Okay. And then I am on with Ross as well. I think as a couple questions

Ross Nussbaum - *UBS - Analyst*

Yes, hi, guys. Can you just quantify where are your street rates today versus expiring?

Karl Haas - *EXTRA SPACE STORAGE INC - COO*

Well, I am not sure I have like where it is to expire. Well, we have more where they are compared to the average existing customer and they are relatively comparable. Where they are to last year is also relatively comparable.

Ross Nussbaum - *UBS - Analyst*

Okay so you're saying it's basically flat?

Karl Haas - *EXTRA SPACE STORAGE INC - COO*

Yes

Ross Nussbaum - *UBS - Analyst*

Okay. And on the renewals what are you, what is the percentage increases and how often are you pushing those through?

Karl Haas - *EXTRA SPACE STORAGE INC - COO*

We are pushing them through at about the same level as we have in the past, about once every nine months. They are in the range of about 6%.

Ross Nussbaum - *UBS - Analyst*

Okay. And then on the acquisitions that you have done, can you just walk through pricing. How are you approaching it, what are the going in yield in terms of the ones where you've got reasonably full occupancy and what are you underwriting to on the ones where there some lease up?

Kent Christensen - *EXTRA SPACE STORAGE INC - CFO*

Well, the, this is Kent, for the stabilized, for properties that are stabilized we're pricing them between a 7.5 and 8.5 cap. And properties that are leasing up we're hoping to achieve that same kind of a cap rate within 12 months of when we have acquired the properties.

Ross Nussbaum - *UBS - Analyst*

So you're not seeking a higher yield on those to compensate for the leasing risk?

Kent Christensen - *EXTRA SPACE STORAGE INC - CFO*

No, they would be on the higher end of that 7.5 to 8.5 range.

Ross Nussbaum - *UBS - Analyst*

Thank you

Operator

Our next question comes from Mike Bilerman with Citi. Please proceed with your question.

Mike Montanan - *Citigroup - Analyst*

Hi, it's [Mark Montanan] here for Michael. Just had a question on the trends you are seeing and the size of the units that are being leased, looking at the move-in, move-out trends. You wouldn't predict that the occupancy gains would be to the level that you were able to achieve this quarter. Wondering if you are seeing something in the size of the units that is driving some of that?

Karl Haas - *EXTRA SPACE STORAGE INC - COO*

Nothing, this is Karl, nothing really dramatic. If there is anything it's a little bit in the direction of smaller units that we are seeing a little bit higher trends, but nothing really that you would say is significantly impacting the overall.

Mike Montanan - *Citigroup - Analyst*

Okay and then on the assets that you acquired in the quarter and those post quarter, can you give any metrics around going in yields, what upside there is, if any, some of the thesis behind? Others were (inaudible).

Kent Christensen - *EXTRA SPACE STORAGE INC - CFO*

The, probably once again had just the previous caller asked a similar question, but 7.5 to 8.5 cap rate and most of those properties, I would say 70% of them are stabilized properties and some of the properties are in lease up and on the lease up ones we are expecting to get on the higher end of that range of 7.5 to 8.5.

Mike Montanan - *Citigroup - Analyst*

Okay and then lastly on the redevelopment or on the development delivery typically leasing up over 36 months or so, just wanted to understand a little better what the pace of stabilization is that you're seeing today based on real-time lease up trends?

Kent Christensen - *EXTRA SPACE STORAGE INC - CFO*

We have about 25 properties that are currently leasing up and we are looking at the numbers based on the pace of lease up. About one-half of them are a little behind what we thought and one-half of them are a little ahead of what we thought. Overall, and then we have some on the outliers. We have some that are going really slow and some that are going really fast. The overall average of all of those properties is right on budget for what we had expected. That being said, our rental rates are somewhere between 10% and 15% below what we had expected them to be when we did the underwriting. We said that earlier this year and it's been about the same. We haven't had to drop our rates any more this year to continue the lease up pace that we are seeing.

Mike Montanan - *Citigroup - Analyst*

Okay. Great, thank you very much.

Operator

Our next question comes from Todd Thompson with KeyBanc Capital Markets, please proceed with your question.

Todd Thompson - *KeyBanc - Analyst*

Hi, good afternoon. I am on with Jordan Sadler as well. Just had a quick question back to acquisitions, last quarter you mentioned that there was a small portfolio that was being marketed, about 25 properties or so, is that still floating around, are you generally, are you still seeing that? And then just additionally, are you generally encouraged by what you're seeing in the market today?

Kent Christensen - *EXTRA SPACE STORAGE INC - CFO*

The portfolio is, they are in the process of closing on that 26 property portfolio. We did bid on it and what we can tell you is that there were, what we have been told is there were numerous bids and we were not successful in any of the properties that we bid on. But they have not announced yet who the bidder was and what the pricing and all of that is, so I don't know that yet. All I can tell you is that in the five properties that we are acquiring between now and the end of the year it is not any of those. And then I'm sorry, Todd, what was your second question, I already forgot.

Todd Thompson - *KeyBanc - Analyst*

Just if you are generally encouraged by the acquisition opportunities that you are seeing in the market

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Kent Christensen - *EXTRA SPACE STORAGE INC - CFO*

Absolutely we are encouraged. There is a lot more activity, but at the same time there are a lot more people that are out there wanting to buy properties and so the competition is increasing. So more properties for sale, but more competition of people who have cash that are wanting to buy.

Todd Thompson - *KeyBanc - Analyst*

Okay. And then just taking a look at the guidance update and some of the revisions, it looked like your forecast for tenant reinsurancing company increased by modest amount and then taxes associated with the TRS declined a bit, I guess this is sort of the opposite of what I would have expected to see. Can you just comment on what might be driving those changes?

Karl Haas - *EXTRA SPACE STORAGE INC - COO*

As we go throughout the calendar year working with our auditors and our accountants on the tax provisions and the other aspects that's going on inside the Company, there are other things that drive the taxability and the TRS and there are ways, that we are trying to find ways of trying to reduce the tax liability that we had and so in this quarter we were able to come up with a couple of things and making arguments to our auditors that should bring our tax down a little bit, which offset the increase from the tenant insurance.

Todd Thompson - *KeyBanc - Analyst*

Okay. And then just lastly with today being the last day of the month, I was just wondering if you could give any comments on where October occupancy is or how performance trended subsequent to the end of the quarter?

Spencer Kirk - *EXTRA SPACE STORAGE INC - Chairman & CEO*

This is Spencer. We have still got a really nice day ahead of us tomorrow, but I would characterize October as being well within the normal bounds, both on rentals, vacates and the occupancy trends. It's all perfectly in line with the season we are in.

Todd Thompson - *KeyBanc - Analyst*

Okay. All right, thank you.

Operator

Our next question comes from David Toti with FBR, please proceed with your question

David Toti - *FBR - Analyst*

Good afternoon, guys. Hi, David. Couple questions. Did you run any market tests in the last couple of months relative to and I'll ask you this every quarter, but I know you guys are pretty active in trying out different strategies around concession types and pushing rents sort of disproportionately relative to the portfolio?

Karl Haas - *EXTRA SPACE STORAGE INC - COO*

Yes, this is Karl. We continue to try -- we just have numerous tests ongoing. One right now we are working on is looking at trying to vary the discount to see if we can sell units with less of a discount. It's still in process and kind of early in the test.

David Toti - *FBR - Analyst*

Helpful. And then just moving on to acquisitions, it seems you have shifted your focus from acquiring from the joint ventures to acquiring from the third party pipeline. Is the JV portfolio still available as well and any update around that possibility?

Spencer Kirk - *EXTRA SPACE STORAGE INC - Chairman & CEO*

David, it is Spencer, once again there has been no shift on the part of Extra Space in terms of our philosophy. With JV opportunities, if and when they appear, we are very eager to pursue them. With the third party management business what we have tried to do is just simply say this is the way to grow our footprint and also create a quasi-proprietary acquisition pipeline.

David Toti - *FBR - Analyst*

Great. And then relative to the third party acquisitions, is there an increased opportunity to use OP currency there? Have you had any discussions along those lines with some of the sellers?

Kent Christensen - *EXTRA SPACE STORAGE INC - CFO*

This is Kent. Yes, there are in the discussions we have with the people that we are acquiring their properties, generally we have a discussion with them about OP unit and then it comes down to what their tax situation is and whether or not they want to hold our stock. And so to date we have yet to close any of those transactions with OP units, but in every instance we have a discussion with them about them.

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David Toti - *FBR - Analyst*

Great. And then maybe just if you could just update us on some recent discussions, obviously, you have made some progress in changing the terms on your revolver, what is the lender tone that you are hearing relative to the banks, especially with regard to development?

Kent Christensen - *EXTRA SPACE STORAGE INC - CFO*

Still very difficult to get construction loans today. It's getting slightly better, but slightly better from zero is not very much.

David Toti - *FBR - Analyst*

Okay, I'll yield the floor. Thanks, guys.

Operator

Our next questions comes from Smedes Rose with KBW. Please proceed with your question.

Smedes Rose - *KBW - Analyst*

Hi, thanks. I just wanted to make sure I understand your guidance correctly. In the, after the second quarter you had pointed to $0,.82 to $0.85 for the year, you are increasing it to $0.88 to $0.89, but that does include the $0.02 impact, right? So it would be $0,90 to $0.91 adding that back? That is correct. Okay. So -- .

Kent Christensen - *EXTRA SPACE STORAGE INC - CFO*

The current guidance includes the charge we have this quarter

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Smedes Rose - *KBW - Analyst*

And your previous guidance did not?

Kent Christensen - *EXTRA SPACE STORAGE INC - CFO*

That is correct

Smedes Rose - *KBW - Analyst*

So on an operating basis adjusting it's kind of really like a $0.06 to $0.07 increase from your previous guidance?

Kent Christensen - *EXTRA SPACE STORAGE INC - CFO*

That is correct

Smedes Rose - *KBW - Analyst*

And you beat in the third quarter relative to your guidance and it seems like fourth quarter would need to come up now and I am trying to sort of back fit that against some of your opening remarks that sounded a little bit, I guess, a little more sobering than I would have expected in terms of trends and the pace of recovery. So is it really more sort of just the lower interest expense that you're looking for that's really kind of driving that upside? Or do you just sort of feel like the, I don't know, costs have to go up now in the fourth quarter or -- . Can you just help me kind of understand a little more what you're saying?

Spencer Kirk - *EXTRA SPACE STORAGE INC - Chairman & CEO*

Smedes, this is Spencer. The question is one of sustainability. And I would characterize it this way, our revenue growth has been very good and we have benefited from operational revenue management marketing systems that have allowed us to maximize our rentals and the rate at which we make those rentals. We have gone up against pretty easy comps from 2009 and going forward these comps are going to get a lot harder as the economy improves. And our NOI growth this quarter is really due to some lower expenses. And so I don't think it's realistic to expect to have negative expense growth going forward and I would say we are returning to normalcy. And I just want to stress that and that is why the comments are what they are. We see a moderately positive slope recovery and along that slope you will have some ebbs and flows. And with that I think that we have got the right trajectory and we are pleased with the results of the quarter.

Smedes Rose - *KBW - Analyst*

Okay, that helps, thanks. And then can you just -- what is the penetration now for the tenant reinsurance, I guess, system wide?

Karl Haas - *EXTRA SPACE STORAGE INC - COO*

This is Karl. We are very, very close to 60%, but we haven't gotten there yet

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Smedes Rose - *KBW - Analyst*

60%, okay. Okay, thank you

Operator

Our next question comes from Michael Knott with Green Street Advisors, please proceed with your question.

Michael Knott - *Green Street Advisors - Analyst*

Hi, guys. Spencer or Karl, just curious what you think sort of a normalized annual average occupancy is for you guys in this kind of environment may be looking out over the next couple of years and maybe contrast that with where was in the peak

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Spencer Kirk - *EXTRA SPACE STORAGE INC - Chairman & CEO*

This is Spencer, Michael. I think optimally what we are trying to achieve is a maximization of revenue. And drawing on 33 years of experience, going back to the founding of this Company with Ken Woolley, and then more recently systematically testing various theories statistically, we kind of think that the optimal occupancy is mid to high 80s and compared to prior more normal periods that's kind of where we philosophically have run the business and that's where we want to run the business until we get something that indicates that we ought to be doing something differently. Now, I would temper that. That's in the macro, in the micro there are various markets where you might want to have different occupancy targets depending on the dynamics in that region, but holistically mid to high 80s is philosophically where we are steering things.

Michael Knott - *Green Street Advisors - Analyst*

Okay. So you getting there, but you think there should be room for further growth as your moderate recovery, as you termed it, continues to unfold?

Spencer Kirk - *EXTRA SPACE STORAGE INC - Chairman & CEO*

That's correct

Michael Knott - *Green Street Advisors - Analyst*

Okay. And then can you just remind us about the economics of adding extra stores to the management program? I know you added quite a few this year. Can you just talk about maybe initial cost and then sort of incremental costs and how it adds to the management franchise fees and sort of you're thinking on how big your appetite is to continue to grow this part of your business.

Spencer Kirk - *EXTRA SPACE STORAGE INC - Chairman & CEO*

The latter part, Michael, is our appetite is significant. We think this is a very healthy way to grow our business, not only the footprint but also as I spoke about earlier to create an acquisition pipeline. The incremental costs. When we rebrand a property, obviously, there is little up front there, $15,000 to $20,000 maybe $25,000. Put a new computer and our systems inside the store and a few other things. As you look at the efficiency, I think there are easily quantified things and then there are those that are not so easily quantified. We do believe that it's $0.01 to $0.02 per 50 properties that we can just say this is the gain.

But I think that there are other gains that are a little more qualitative. For instance, with a larger denominator over which we can spread our expenses for our Internet marketing campaigns or our national accounts campaign or several of the other things that we are doing. I have to say on the balance we think that this is an accretive business. It increases our footprint, it builds the brand, and at the end of the day it gives us a growth opportunity because we are finding out that we believe that the past year is maybe a pretty good indicator of maybe what we can expect and that is that a significant portion of our acquisitions can come from our JV and third party managed business and we think these relationships are important today and we think they are going to be just as important going down the street looking into the future.

Michael Knott - *Green Street Advisors - Analyst*

Is the opportunity there match your significant appetite?

Spencer Kirk - *EXTRA SPACE STORAGE INC - Chairman & CEO*

Today I would say no. We would like to be doing more, but as things are stabilizing and returning to normalcy, I would say the trend very much is starting to marry up with the appetite.

Michael Knott - *Green Street Advisors - Analyst*

And then last question and I'll hop off. Can you remind us of your target debt to EBITDA or leverage ratio in terms of how you think about the business and then also your philosophy on the mix of fixed and floating debt?

Spencer Kirk - *EXTRA SPACE STORAGE INC - Chairman & CEO*

I'll let the fixed and floating question kick over to Kent. Let me take the current EBITDA question or debt to gross asset value or any of these other things. We have had tremendous improvement in our balance sheet. The debt to EBITDA has gone from 7.8 to 6.8. The question is where should that threshold be and I think there are a lot of economic and financial factors that will determine that. It depends on what we do in the capital markets, it depends on a lot of other things, but I would say once again the trajectory is one of improvement, and we think that the leverage that we have today on our business is a good thing and is a great thing for our shareholders. And with that I'll let Kent talk to the fixed versus variable.

Kent Christensen - *EXTRA SPACE STORAGE INC - CFO*

A lot of our variable rate debt today is loans that are coming due in the next 12 to 36 months based on where we believe interest rates are going in the short-term. We'll probably back that variable rate loans that we are putting in place today that are going to be longer-term loans, we'll be fixing those loans for longer periods of time at fixed interest rates. So that's -- we are not wanting to put the current variable rate loans that are expiring in the near-term, we won't be swapping those out.

Michael Knott - *Green Street Advisors - Analyst*

So the proportion won't be reducing in terms of floating rate?

Kent Christensen - *EXTRA SPACE STORAGE INC - CFO*

It'll be reducing in that the, we will be -- over time it will reduce in that we will be replacing longer term loans that will be paying off was the shorter term loans that are coming due.

Michael Knott - *Green Street Advisors - Analyst*

Yes, thanks.

Operator

Our next question Michael Salinsky with RBC Capital, please proceed with your question.

Michael Salinsky - *RBC Capital Markets - Analyst*

Good afternoon, guys.

Spencer Kirk - *EXTRA SPACE STORAGE INC - Chairman & CEO*

Hi.

Michael Salinsky - *RBC Capital Markets - Analyst*

First question on the purchases you mentioned, the five under contract, where are those located?

Kent Christensen - *EXTRA SPACE STORAGE INC - CFO*

The five that we are going to purchase?

Michael Salinsky - *RBC Capital Markets - Analyst*

Yes

Kent Christensen - *EXTRA SPACE STORAGE INC - CFO*

Texas, Salt Lake and New York.

Michael Salinsky - *RBC Capital Markets - Analyst*

Okay. Second of all, question for Karl, have you noticed any discernible trends between maybe commercial versus residential. Now as we made it through the summer here, are you seeing any differences between the two?

Kent Christensen - *EXTRA SPACE STORAGE INC - CFO*

No we really haven't

Michael Salinsky - *RBC Capital Markets - Analyst*

Okay. Third in terms of tenet reinsurance, obviously, it's been a big area of success over the past couple of years here. Just wondering how much upside is left in that if you exclude out the 3+ management program there?

Karl Haas - *EXTRA SPACE STORAGE INC - COO*

Yes, we think we are pretty much reaching our peak. We might have some opportunities as we go forward to tweak the program a little bit and find ways to squeeze a little bit more out of it, but the penetration levels, there is a certain percentage of the customers you can never get. And so there are going to be some caps, but we are still looking at opportunities. We have some new stores that we take over that have -- we have some exceptions that have considerably above the 60%, but on the macro it's really been a struggle to get this last from like 55% to 60%. It's been painfully -- our goal for the year was 60% and we are at 59.8% right now, I think, we've been just baby steps getting up and it's not a result of us and it is not for a lack of pushing it hard.

Michael Salinsky - *RBC Capital Markets - Analyst*

Okay. And finally, just as you look to move into external growth over the next couple of years via acquisitions, you indicated you are comfortable with the balance sheet. It is thought to match fund, maybe move to like something like an ATM or any thoughts on asset recycling or how do you expect to fund growth initiatives over the next, call it, 12 to 18 months?

Spencer Kirk - *EXTRA SPACE STORAGE INC - Chairman & CEO*

Michael, it's Spencer. We are looking at all avenues. An ATM is obviously an option. A broader larger offering if an offer we are looking at and exploring all things. I think matched funding is important to us. We've got 66 unencumbered assets today and when the appropriate opportunity is realized, I think you'll find Extra Space being A, creative and B, using every resource at its disposal to get the job done. And I think our track record speaks well for that.

Michael Salinsky - *RBC Capital Markets - Analyst*

Okay. Are you seeing enough volume right now as to where that would be something you would be looking at in the near-term or is it something kind of longer-term out there. You feel you have enough capacity now.

Spencer Kirk - *EXTRA SPACE STORAGE INC - Chairman & CEO*

I think the word for me is intermediate, Michael, It's not going to happen tomorrow and it's not a year away, it's kind of an intermediate thing for us.

Michael Salinsky - *RBC Capital Markets - Analyst*

Okay, it's good for me, guys. Thanks.

Spencer Kirk - *EXTRA SPACE STORAGE INC - Chairman & CEO*

Thank you.

Operator

Our next question comes from Todd Stender with Wells Fargo, please proceed with your question

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Todd Stender - *Wells Fargo - Analyst*

Hi, thanks. On the acquisitions you made in the third quarter and then also the stuff for the fourth quarter so far, have you assumed any debt on those properties?

Kent Christensen - *EXTRA SPACE STORAGE INC - CFO*

I think two of the properties we acquired had loans that we are assuming.

Todd Stender - *Wells Fargo - Analyst*

Okay.

Kent Christensen - *EXTRA SPACE STORAGE INC - CFO*

Mostly, all the rest of them we will just be using cash to pay. Just cash. Okay, thanks.

Todd Stender - *Wells Fargo - Analyst*

And the expectations for interest expense have come down looks like about $0.03 to $0.04 a share. What's driving that, what has changed there?

Kent Christensen - *EXTRA SPACE STORAGE INC - CFO*

First is that we at the beginning of the year we had expected that we would be sitting on a lot of cash and that was the proper thing to do, but as we have gone through the year we have determined that loans are available to us and we don't need to sit on the cash and so we have taken that cash and paid down debt. So that has brought our interest rate down. We were able to pay a number of loans off early, which is why the interest costs are down.

Second, we had some trust preferred -- part of our debt we have some preferred stock, which are trust preferred. They are a preferred stock, but because they become due, they come due in 30 years from the day that we entered into those agreements. We are required to report them as debt. When we did the transactions five years ago, we locked the interest rate on those trust preferred document or trust preferred securities. Some of those have, the locks have expired and we have allowed to allow them to shift from fixed rate to variable rate. And so the interest rate before was about 6% and it's dropped to LIBOR plus 240, so we are below 3%. So we are getting a pretty good pickup on those trust preferred securities today. So it's a combination of those things that has brought our interest rates down. Or interest cost down, sorry.

Todd Stender - *Wells Fargo - Analyst*

Okay, thank you. And what course of action do think you will take for the $22 million of debt that comes due in December?

Kent Christensen - *EXTRA SPACE STORAGE INC - CFO*

We will just be paying that loan off.

Todd Stender - *Wells Fargo - Analyst*

Okay. And just switching gears. With the 21 properties that you put into your third party management program in the third quarter, pretty consistent with the second quarter. In general, is there any seasonality with that business?

Kent Christensen - *EXTRA SPACE STORAGE INC - CFO*

In that we have only about a year and a half ago really started into this. We have no idea whether there is seasonality or not because it just continues to grow and grow. So today we don't know the answer to your question. Maybe after we have been doing this for five years we can give you some more history on that. But every month that goes by we get more and more people interested in what we are doing and the program does seem to be growing and accelerating. Part of it is because of how well Extra Space is performing. I think it becomes very difficult for the local operators, the smaller operators to look at what they are doing and what we are doing and compete with us. And I think that is driving a number of these people to look at what we are doing.

Todd Stender - *Wells Fargo - Analyst*

Okay thank you.

Operator

Our next question comes from Lindsey Yau with Robert W. Baird, please proceed with your question

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Lindsey Yau - *Robert W Baird - Analyst*

Thank you. Spencer, can you just elaborate a little bit more on that return to normalcy. What do you think is kind of a sustainable NOI growth rate, because I know maybe late '06 you guys hit around 10%. Is that where we are headed?

Spencer Kirk - *EXTRA SPACE STORAGE INC - Chairman & CEO*

I think we need to look over the course of the last decade. Obviously there are a lot of points of volatility in the world in which we live. I would say normalcy for me on NOI is three, four, maybe five, if you're doing really well. And I think to expect more than that with a largely jobless recovery and a few other things is not reality. So for the current economic condition and for the foreseeable future that's the range I would bracket it.

Lindsey Yau - *Robert W Baird - Analyst*

Okay, thank you. I think this question will be for Karl. Can you give a little bit more color on maybe some of these specific markets where there is some weakness. For instance, it looks like Seattle had significant NOI drop for this quarter. Anything in particular driving that?

Karl Haas - *EXTRA SPACE STORAGE INC - COO*

Well, I mean, our worst markets are Las Vagas and this is not going to come as a surprise to you, Las Vegas, Phoenix and Florida, where as Florida is actually starting to bounce back and we are seeing some positive stuff start to happen there. Las Vegas and Phoenix are continuing to suffer. LA is suffering, Sacramento, those are probably the worst markets. I will say that LA is probably the only one that is kind of, that we are not seeing an improvement in the negative delta.

Lindsey Yau - *Robert W Baird - Analyst*

Okay. And then finally, just on the construction financing where you need $18 million is that already with construction loans that you have closed or is that loans that you still need?

Kent Christensen - *EXTRA SPACE STORAGE INC - CFO*

The $18 million is still necessary for us to finish our projects as plan,we are planning on using cash for that. However, we are trying to get loans on those properties that are under construction, not just the six that are not completed, but there are others that are done that we never were able to get a loan on those. So we are still trying to get loans on all of that to be able to try to fund that $18 million was some kind of debt. That's why we talk about the construction loan process is still very difficult. We are getting loans here and there, but -- and ultimately, we hope to have loans on all of the properties that should fund the $18 million. But in case we don't, we have the cash we need to complete the development of these six projects.

Lindsey Yau - *Robert W Baird - Analyst*

Great, thank you.

Operator

Our next question Paul Adornato with BMO Capital Markets, please proceed with your question.

Paul Adornato - *BMO Capital Markets - Analyst*

Just a follow-up on the tenant reinsurance. You said that you are pretty much maxed out at about 60% penetration, but I was wondering how you priced that product. Is it a flat rate or is it based on estimate of value. Do you have any opportunities to up-sell that item?

Karl Haas - *EXTRA SPACE STORAGE INC - COO*

Yes, there are and I was probably a little bit, maybe not giving enough of the upside that is there. It is fixed. It is based on, we charge the same amount across the country based on the level of insurance, $5000, $7500, $10,000 and there is some opportunity to up-sell. There are also, as we grow, when we bring new properties into the system, they typically are, you have very, very low tenant insurance penetration, so that we have some upside. On these like acquisitions, typically they come in with almost no tenant insurance penetration, so that also provides some upside. And we think there might be some opportunities to push that 60% a little bit above 60%, but we just don't see it growing as quickly as we have seen it grow over the last three years.

Paul Adornato - *BMO Capital Markets - Analyst*

Okay, understood. And looking at the development pipeline, with the kind of end of the development pipeline in sight and a return of the capital markets and operating markets to more normalized levels, was wondering if you would consider restarting a development pipeline, given that acquisitions are relatively tough and you might be able to capture that development premium given your expertise in the space?

Spencer Kirk - *EXTRA SPACE STORAGE INC - Chairman & CEO*

Paul, it's Spencer. The settlement program was shut down and we have viewed that as a permanent decision for a variety of reasons and I'll talk about that in a second. Nonetheless, not wanting to be closed minded, we always are asking ourselves what if? The reason I tend to be strong in my language and say it's permanent is Kent just again articulated that even with $1 billion balance sheet it's very very, very difficult to get development loans and we need that leverage to make these projects pencil. The second reason is the cycle of doing development is not something, in self storage, where we just flip the switch. Most other properties types you can flip the switch.

And if you consider it takes one to two years to get entitlements and your permits. Then it takes another year to lease up or to construct the project and then a lease up of anywhere from 24 months to 48 months, this is a 4, 5, 6 year proposition. And today, as we look at the market, we don't see the fact that restarting a development project incurring the dilution and having a program that is large enough to move the needle is compelling. And we take all of these factors and I just once again want to reiterate that the decision in Extra Space, because of self storage's unique profile and protracted process to bring a property on line successfully over several years, want me to again reaffirm that we have looked at it as a permanent decision.

Paul Adornato - *BMO Capital Markets - Analyst*

Okay, appreciate the comments. And finally, if we were to look back at the time of the IPO and obviously going back to the founding of the Company, you guys had at that time a very, very infill oriented portfolio. Was wondering if over time you wanted to move more towards urban areas as perhaps a final frontier in terms of penetration of storage throughout the country?

Spencer Kirk - *EXTRA SPACE STORAGE INC - Chairman & CEO*

The quickest way I can answer that question is mentally draw a grid in your mind or a quadrant. And you have high income, low income and you have high density and low density. And if you take those rows and columns and start to fill in those quadrants, high income, high density, great. High income, low density great. You rounded out and you end up with just one quadrant that doesn't work and that's low income, low density. And what I would simply say is we like infill locations, but primarily we want to be where people are and where the incomes are solid so that we can justify what we are doing. With 52,000 or 54,000 self storage facilities in the United States, I would say at least half of those are in markets where we have no business given our shareholder base. We want to be a solid operator in markets that provide meaningful growth opportunities.

Paul Adornato - *BMO Capital Markets - Analyst*

Okay, thank you, guys.

Operator

Our next question comes from Mike Bilerman with Citi, please proceed with your question.

Mike Bilerman - *Citi - Analyst*

Yes, just two follow-ups. In terms of managed portfolio you look at the composition there, the occupancy, obviously, is much lower and the average rate and average rent per foot I Lower and I understand a lot of these are coming into the portfolio to get enhancing operations that you're bringing, but is there a quality gap between the manage portfolio and the court owned portfolio?

Karl Haas - *EXTRA SPACE STORAGE INC - COO*

A little bit. Yes. This is Karl. In general, in some cases there -- a lot of times the quality that you need depends on the market you're in. And while I think our own portfolio is very much in the most competitive markets and the top end markets, so you need to have higher quality product as you compete against higher quality product. When you get in less, the less dense, the less high rent per square foot markets, you can have a little bit less quality because they are competing against lower quality. Does that answer your question?

Mike Bilerman - *Citi - Analyst*

Oh, yes. Well, how much overlap is there between the management portfolio that you have, the 157 assets, relative to the stuff that you wholly-own or are in JVs in terms of market penetration or --?

Karl Haas - *EXTRA SPACE STORAGE INC - COO*

It just comes down to a lot of it is in different markets. A lot of our third party management is, for instance, is in Atlanta. A lot of it will be taken over. And in that case, they are very nice properties, but it's a really tough market. So -- and we also, we turn down a good number of properties that come to us when they don't meet our quality standards.

Mike Bilerman - *Citi - Analyst*

And you are, you are putting this on the Extra Space brands?

Karl Haas - *EXTRA SPACE STORAGE INC - COO*

Yes. Everything we manage we change the signage. We go in and do some minor reimaging to make it clear that it is an Extra Space property.

Mike Bilerman - *Citi - Analyst*

And how much capital is that for the owner to put in on the conversion of the asset and sort of how are you maintaining brand standard?

Karl Haas - *EXTRA SPACE STORAGE INC - COO*

It's not dramatic. We don't require them to, for instance, go in and repaint the property, repaint the doors, things like that. We do more what people see from the street and people walking into the office and even in that, we are not, even in our own portfolio there is a lot of variation in what the offices look like. It's more the sign and the posters and things like that that we use to establish the brand image in these properties.

Mike Bilerman - *Citi - Analyst*

And then the term of the contracts are typically how long?

Kent Christensen - *EXTRA SPACE STORAGE INC - CFO*

Three years.

Mike Bilerman - *Citi - Analyst*

Okay. And just moving on page 18 of the supplemental, there is move ins and move outs. I'm just curious, you look at the move-in activity and this is just on the same store for the quarter, your move-ins were down and the move-out were greater. But yet your occupancy is up 100, 200 basis points on average year-over-year, which would indicate, I think, if I am reading this the right way, that the people moving in are taking larger spaces than the people who are moving out by the tune of almost 350,000 square feet.

Karl Haas - *EXTRA SPACE STORAGE INC - COO*

No, that's not -- because you have got to look at -- this gets a little complicated, but it's -- our delta it require a year in occupancy. At the end of the second quarter what we told you was, I think, 2.2% 2.3%, where as our delta at the end of this quarter is 1.8%. So the gap to last year has actually slid a little bit, which is the first time since last April of '09 that that has occurred.

Mike Bilerman - *Citi - Analyst*

That's really the change year-over-year is really a sequential change?

Karl Haas - *EXTRA SPACE STORAGE INC - COO*

Right.

Mike Bilerman - *Citi - Analyst*

Okay

Karl Haas - *EXTRA SPACE STORAGE INC - COO*

So you could have -- so we have had slightly more vacates, slightly less rentals and so we have had a little bit of a slide in the occupancy delta. Still very healthy at the 1.8% and the fact that we are going against some stronger numbers, as Spencer mentioned, the second and third or the third I guess really the third and the fourth quarter of last year got better. And we were making good progress, especially on occupancy.

Mike Bilerman - *Citi - Analyst*

Now did that trend in October as well, where your move-ins were lower than your move-outs?

Karl Haas - *EXTRA SPACE STORAGE INC - COO*

No, we are actually holding pretty steady. October is looking pretty good, actually, for release last Saturday, Sunday.

Mike Bilerman - *Citi - Analyst*

Okay, thank you.

Operator

We have another follow-up from Christy McElroy with UBS, please proceed with your question

Ross Nussbaum - *UBS - Analyst*

Hi, it's Ross Nussbaum here. Guys, I want to go back. There was a comment made earlier in the Q&A that in an environment, in the current economic environment, sort of a jobless or lackluster recovery you think 3% to 4% to maybe even 5% NOI growth is possible. Did I hear that correctly?

Spencer Kirk - *EXTRA SPACE STORAGE INC - Chairman & CEO*

Yes. If you say what are the ranges, Ross, it's entirely possible. Our best guess is what we have communicated, we think that somewhere in the range of 3% to 3.5% is what we believe in.

Ross Nussbaum - *UBS - Analyst*

So if I backed that into same store revenues, right, with your margins that probably means you're looking at 2%-ish revenue growth. Is that about right?

Spencer Kirk - *EXTRA SPACE STORAGE INC - Chairman & CEO*

Pretty close

Ross Nussbaum - *UBS - Analyst*

Okay. So help me a little get to the math behind how do you generate 2% revenue growth ultimately, if you are raising rents 6% on renewals every nine months, what percentage of your customers are staying nine months and are actually getting that 6% rent increase?

Spencer Kirk - *EXTRA SPACE STORAGE INC - Chairman & CEO*

I have no idea without doing some homework on that, Ross, I can't speculate because I haven't run the math

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Ross Nussbaum - *UBS - Analyst*

But I would assume it's a reasonably lower number, right, it's not half the 10?

Spencer Kirk - *EXTRA SPACE STORAGE INC - Chairman & CEO*

That's probably correct, yes.

Ross Nussbaum - *UBS - Analyst*

Okay. So I guess then I start thinking about to the extent that you have raised rents on customers 6% this year and street rents don't appear to be moving higher yet, are we going to find ourselves in a situation next year where you are rolling rents down on certain customers, as guys who saw renewal increases leave at some point?

Spencer Kirk - *EXTRA SPACE STORAGE INC - Chairman & CEO*

I don't forecast rolling rents down. Once again, we are trying to communicate, Ross, an amalgamation of a lot of different markets. And we have some markets that are doing very well that we have communicated in our release, we have some markets that continue to be challenged. And how this all plays out is anybody's guess. What we've tried to do is just be conservative and say given the economic environment in which we are operating, I don't think storage and particularly Extra Space is going to go negative and I don't think it's realistic to expect 7.8% NOI growth going forward. We're going to operate in some band and as the economy unfolds in 2011 and as various markets ebb and flow or improve or maybe don't improve, it's anybody's guess and that is why I am not willing to take a hard stance on that.

Karl Haas - *EXTRA SPACE STORAGE INC - COO*

Ross, if I can add some, this is Karl. Clearly that's one of the reasons that we are being cautious about the future right now is on the long run, if there is, if you don't have the ability to push street rates, it will challenge our opportunity to grow, because you can only push existing customers so far. We have caps on how far the gap can be on existing customers and that we still increase them. So we are looking for different levers and right now we are benefiting from lower discounts and higher occupancy and actually lower bad debt, but, ultimately, for the industry as well, we've got to have the ability to push rates. Now the good news is there is no new inventory coming in, no new properties being built, and so that should help. But we are continuing to see -- we are not able to, coming out of the recession, we are not able to push street rates 4% or 5% or 6% yet.

Ross Nussbaum - *UBS - Analyst*

How much of a factor -- the occupancy growth that the industry has seen over the last year-ish seems to be almost entirely driven by a decline in vacates rather than an improvement in rentals. And now we are hitting that crossover point, right, were in order to generate net absorption, right, we need the demand to start picking up and it appears that the state of the housing market and the state of consumer seems to be making that a tougher transition then maybe we all would have thought three or six months ago. Do you guys believe at this point, seeing how demand has played out this year, that you need a housing recovery to play out to see demand in rentals turn positive.

Spencer Kirk - *EXTRA SPACE STORAGE INC - Chairman & CEO*

A housing recovery would be nice. Once again let's go back to the macro drivers of this business. If I could be really direct, a lot of people have tried to find collative measures, Ross, that will predict the success of storage. And we've talked about this previously . Housing is just one element of a broad amalgamation of factors that determine demand for our business and that is what I like about storage. It is a broad-based consumer product that is need driven and housing is only a component of what makes our business or doesn't make our business and I like the broad diversification. In terms of drivers I like the broad geographic diversification. I like many of the elements that say, you know what, we are not contingent on any one economic driver to drive our business and obviously an improving economy will help our business. An improved housing market will help our business. But it's really people in transition that drive our business. And I am comfortable that the comments that have been made and the things that we have released at this point in time are our best prognostication as to what to expect.

Ross Nussbaum - *UBS - Analyst*

Thank you.

Spencer Kirk - *EXTRA SPACE STORAGE INC - Chairman & CEO*

Thank you, Ross

Operator

There are no further questions. We would like to turn the call back over to management for closing comments.

Spencer Kirk - *EXTRA SPACE STORAGE INC - Chairman & CEO*

This is Spencer. In conclusion I would simply like to thank you for joining us today. We look forward to our next earnings call. Have a good afternoon.

Operator

This concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation.