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EXR - Q3 2015 Extra Space Storage Inc Earnings Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Extra Space Storage Inc. third-quarter 2015 earnings conference call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session, and instructions will be given at that time. (operator instructions) As a reminder, this call is being recorded.

I would now like to introduce your host for today's conference, Director of Investor Relations, Jeff Norman. Please go ahead, sir.

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

Thank you, Mallory. Welcome to Extra Space Storage's third-quarter 2015 conference call.

In addition to our press release, we have furnished unaudited supplemental financial information on our website. Please remember that Management's prepared remarks and answers to your questions may contain forward-looking statements, as defined in the Private Securities Litigation Reform Act.

Actual results could differ materially from those stated or implied by our forward-looking statements, due to risks and uncertainties associated with the Company's business. These forward-looking statements are qualified by the cautionary statements contained in the Company's latest filings with the SEC, which we encourage our listeners to review.

The forward-looking statements represent Management's estimates as of today, Thursday, October 29, 2015. The Company assumes no obligation to revise or update any forward-looking statements because of changing market conditions or other circumstances after the date of this conference call.

I would now like to turn the call over to Spencer Kirk, Chief Executive Officer.

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

Hello, everyone.

For 2015, the top two priorities at Extra Space are operational excellence and seamless integration of new stores onto our operating platform. Year to date, our focus on these priorities is paying off.

Operationally, we had a record-breaking quarter. We excelled in producing same-store revenue growth of 9.9%, NOI growth of 12.6%, and a peak occupancy of 94.9%. This enabled us to achieve FFO as adjusted growth of 12.5% on top of last year's growth of 26.3%. This marks 20 consecutive quarters of double-digit increases.

To perform at this level while simultaneously preparing to close a large and complex transaction showcases the depth of our operations team and our ability to execute.

In the first three quarters, we added 82 wholly owned or managed stores to our platform. On October 1, we closed our acquisition of SmartStop and integrated an additional 155 properties. This brings our store count to 1,335, all branded Extra Space.

The preparation to add these stores began months earlier. Thanks to the work of our team and the cooperation of SmartStop, we were able to review financial systems, train employees, plan technology conversions, and evaluate CapEx needs well ahead of closing.

There is still work to be done, but we hit the ground running. This is the right acquisition at the right time for our shareholders, and I'd now like to turn the time over to Scott.

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

Thanks, Spencer.

Last night, we reported FFO of $0.81 per share for the quarter. Excluding costs associated with acquisitions and noncash interest, FFO as adjusted was $0.81 per share, exceeding the high end of our guidance by $0.02.

The beat was primarily the result of better-than-expected property performance. This was partially offset by higher-than-forecasted income tax, as well as an increase in interest expense as we accumulated the funds for the SmartStop acquisition.

Our same-store revenue growth was driven by higher rates to new and existing customers, increased occupancy, and lower discounts. Our top-performing markets year to date include Atlanta, Denver, Houston, Los Angeles, Sacramento, San Francisco, and Tampa-St. Pete, all with double-digit revenue growth. Our platform continues to maximize results in this favorable operating environment.

During the quarter, we acquired 1 store in Maryland for $6.1 million, and we acquired a certificate-of-occupancy store with a JV partner for $5.4 million. Subsequent to the end of the quarter, we acquired 124 stores for just over $1.3 billion.

All but 2 of these stores were part of the SmartStop portfolio. We currently have 9 operating stores under contract for $82 million. Six of these acquisitions totaling $53 million are scheduled to close before the end of the year.

In addition, we have another 17 certificate-of-occupancy stores under contract. The total purchase price of these stores is $177 million, of which $26 million is expected to close in 2015.

We were active in the capital markets in the quarter. We filed a $400-million ATM, under which we sold $31 million. We also issued $575 million in exchangeable senior notes and used a portion of the note proceeds to repurchase $164 million of an existing tranche of exchangeable notes.

The October 1 SmartStop acquisition, as well as our strong year-to-date results, require revisions to our guidance. Our full-year FFO guidance is $2.69 to $2.72 per share. Our guidance includes dilution from our certificate-of-occupancy deals, acquisitions that operate below our portfolio average, and $45 million in transactional and debt-elimination costs related to the SmartStop acquisition that will be recognized in the fourth quarter. Our FFO as adjusted increased to $3.10 to $3.13 per share, which removes the noncash interest and nonrecurring transactional costs.

I'll now turn the time back over to Spencer.

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

Thanks, Scott.

Fundamentals for the sector continue to be strong. New supply, which is still muted, will not be a factor in the next couple of years. We expect occupancy to remain at all-time highs, which should allow us to further increase rates to new and existing customers. Only time will tell if pricing power will remain as strong as it is today, but the fundamentals support a positive outlook.

The acquisitions environment will continue to be extremely competitive, and Extra Space will remain a disciplined buyer. We are focused on accretive acquisitions and maximizing shareholder value. I am pleased with the outstanding performance of our team. We have executed at a high level across the entire organization.

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

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

Thank you, Spencer. In order to ensure we have adequate time to address everyone's questions, I would ask that everyone keep your initial questions brief and if possible, limit it 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'll turn it over to Mallory to start our Q&A session.

QUESTIONS AND ANSWERS

Operator

(operator instructions) Jeff Spector, Bank of America.

Jeff Spector - *BofA Merrill Lynch - Analyst*

Thank you, good afternoon. My first question is on the integration of SmartStop. I know it's only been a month, but any lessons learned you could share with us on the underwriting of the deal, positive or negative, and maybe specifically on some of the new markets you've entered?

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

In terms of underwriting and performance, I would tell you it's probably too early to really comment on that. What I would say is, the properties are performing right where we were expecting them to perform when we put this under contract several months ago. So the occupancy and the revenue performance when we took them over was right where we expected.

Jeff Spector - *BofA Merrill Lynch - Analyst*

Okay. (multiple speakers) I'm sorry, please.

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

With regard to the markets, one of the really nice things about this transaction is in many markets we've picked up an even greater footprint, which is going to give us greater presence digitally on the Internet and allow us to further drive occupancy and rates at those stores. So it's coming together very well. We're pleased.

Jeff Spector - *BofA Merrill Lynch - Analyst*

Okay. So too soon to tell if the underwriting was too conservative. It seems like the integration has gone very well, as you've said, and then acquired properties performing better than expected within the first, let's say, months on other deals?

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

Everything's right on course. It's too early to tell what the trend is, but we're very satisfied with how we started.

Jeff Spector - *BofA Merrill Lynch - Analyst*

Great. And I just had one other question. On the 17 certificate of occupancy under contract, can you provide a little bit more details on that, where those came from, existing markets, some of these new markets?

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

So I would tell you that they are similar markets to where we've been in the past. They're all markets where we currently have properties. They range from Boston to Phoenix, so they're across the US.

These are local developers. Most of them we have relationships with. The majority of them we feel like are going to be very good acquisitions and -- as we've underwritten them, we've underwritten them with, we would say, fairly prudent lease-up assumptions, meaning we've kind of gone to our historical average. We recognized that the market won't always be what it is today.

Some of these CofO deals were out into 2017, even out into 2018. And so we've been prudent in our underwriting assumptions, and we expect them to perform well.

Jeff Spector - *BofA Merrill Lynch - Analyst*

Great, thank you.

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

Thanks, Jeff.

Operator

Vikram Malhotra, Morgan Stanley.

Vikram Malhotra - *Morgan Stanley - Analyst*

Thanks, guys, congrats on the results. I just had a bigger-picture question. Your referenced that supply should not be an issue for the next couple of years. I think we were [searching] maybe 2016, now maybe 2017. You started off same-store NOI in this 8% range, and now clearly your 10% to 11%. Looking forward, what metric, would you say, can continue at a very strong pace, if you were to pick one? And what are you most worried about?

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

Vikram, this is Scott. Obviously, we're not ready to give 2016 guidance, maybe just kind of commenting on where we are today and where we can kind of see things going.

I would tell you, we've had a very good year. I think that we've had outstanding performance. If I look into the next year, I think it's going to be very good.

I think that our occupancy can't continue to have a 200-basis-point delta year over year. Our discounts, we can't continue to push them lower year after year. But I do think we will have some pricing power going into next year, and it'll be a very good year still.

Vikram Malhotra - *Morgan Stanley - Analyst*

And just one clarification. On that pricing part, you very solid growth. Can you give a little bit more color what was the price increase in terms of street rates, how much they grew, and then the price increase to distinct customers?

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

So our existing customers, we continued to increase them in the high-single digits. In terms of the pricing -- our prices and street rates, it depends on the time of the year. During the summer months, we saw 8% growth. So we continue to push on those.

If you look at our waterfall and where our growth came from, our growth came just over 200 basis points in occupancy, about 50 basis points from discounts, and then the rest came from rates, primarily from new customers coming in the door.

Vikram Malhotra - *Morgan Stanley - Analyst*

Great, thank you.

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Operator

Todd Thomas, KeyBanc Capital Markets.

Todd Thomas - *KeyBanc Capital Markets - Analyst*

Thanks. First question, following up on rents and price increases. If I think about your portfolio overall generating rental income growth of 10% in the quarter, some markets obviously well above that, just given the churn you see in your portfolio and the time it takes to re-tenant space when customers move out, that suggests to me that you're increasing rents well above 10% across the portfolio; yet you just mentioned that you're increasing rents to existing customers in the high-single digits, and in the peak season, street rents were only up 8%. So I'm curious, what am I missing that the blended overall portfolio rental income growth in the quarter was 10%?

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

One of the things that happens is, we actually have some negative churn that takes place. So depending on the time of year, our negative churn is typically mid-single digits, but it could go higher than that, depending on what we're going with rates.

So if someone moves in in the summer when they're at peak rates, and then we drop the price in the fall, if someone moves out, you have a negative churn. So that's one of the things they would tell you, just in doing the simple math, you're missing.

And the other one is, we're raising our existing customers high-single digits, but we did that last year. So year over year, it's really not generating a lot of lift to our income.

Todd Thomas - *KeyBanc Capital Markets - Analyst*

So I guess -- both of those actually sound like they'd be headwinds to rental income growth. Is that right? Is that what you're trying to say with that?

So if someone moves in in the summer at a higher rent during the summer, then they move out, and you replace that with someone in the fall or in the winter, that's a lower rent. And same thing with the net increase to existing customers. You're saying that the churn causes that to be lower. But I'm wondering how the blended overall rental income growth in the quarter was 10% when it doesn't seem like you're increasing rents to anybody 10% or more. Street rates were up during the peak 8%, and existing customer rent increases are less than 10%.

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

Correct. So at 200 to 250 basis points in occupancy, you get a half a percentage discount, so that's 3%. You then get the rest from rates.

So if you're pushing your existing customers high-single digits, and you did that last year and maybe slightly more this year, you get a little bit from that. And then we pushed street rates this year 7% to 8%.

Todd Thomas - *KeyBanc Capital Markets - Analyst*

Okay. And then my second question, regarding the CofO deals, I'm curious how big that pipeline will get. During the last cycle, you had about a $300-million development pipeline. Obviously, the size of the Company was much smaller, and it's much larger today. But just curious where you see that pipeline growing. Do you think you'll get back to $300 million, or even higher?

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

Todd, it's Spencer. As you think about a CofO pipeline, the governor for us is dilution. And we've set a target of about 3% of FFO is what we're willing to tolerate. And depending on whether we do those CofO deals just by ourselves or with a JV partner can affect that calculation.

So obviously we'd like to do nice new properties in as many core markets as we can. It's a competitive market, and we have a dilution threshold that we want to be very disciplined so that we don't go backwards.

Todd Thomas - *KeyBanc Capital Markets - Analyst*

Okay. Thank you.

Operator

Todd Stender, Wells Fargo.

Todd Stender - *Wells Fargo Securities - Analyst*

Can you provide some fundamental data points for the operating properties -- or, the one you acquired in Q3. You also have some under contract that you're expecting to acquire in Q4. Just seeing if these are stabilized, and then any details that you can provide.

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

Most of the properties, we're looking at stabilized cap rates in the mid-6s. Your year-one cap rate is usually going to be slightly below that. Some of these properties have a little bit of upside, but not that significant.

Todd Stender - *Wells Fargo Securities - Analyst*

How about occupancy or rental rates, anything -- any context you can provide with those?

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

It's both. And it will depend a little bit on the property. For instance, the one we bought in the quarter had more rate-growth potential, as well as a little bit of occupancy. Going forward, some of the other properties we're looking at buying have a combination of rate and occupancy. And then others just have rate-growth opportunities.

Todd Stender - *Wells Fargo Securities - Analyst*

That's helpful, Scott. And then -- go ahead, sorry.

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

I said it really depends on the property and the market.

Todd Stender - *Wells Fargo Securities - Analyst*

Sure. And just switching gears to the third-party management, we used to talk about it a lot more often. It seems like it's been overshadowed by your good fundamentals, definitely your entry into CofO deals. I just wanted to get a sense of how much the third-party management pipeline that provides you guys with acquisition opportunities, how much of that is still in place.

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

It still is the prime reason we're in the business, Todd, to create an off-market acquisition pipeline. We haven't made a lot of noise about it, but we added 43 managed assets on the SmartStop acquisition. And by the end of the year, we will have grown that pool by more than 100 assets.

So for us, there's this strategic opportunity that it presents, and we continue to buy from that portfolio that we manage. We also get economies of scale and the tenant insurance and the power of spending more on the Internet in those respective markets. So it continues to be a very important part of our business.

Todd Stender - *Wells Fargo Securities - Analyst*

Great, thanks, Spencer.

Operator

George Hoglund, Jefferies.

George Hoglund - *Jefferies - Analyst*

Just one question on the outperformance relative to the peers on a same-store NOI basis. It's been pretty substantial this year. I'm wondering what do you guys think the driver of that is? I know part of it can be how you guys determine the same-store pool relative to the peers, but what else would you attribute your outperformance to?

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

It's tough to comment on their results. I would tell you we put information in our supplements, breaking out our current pool versus our last-year's pool. But I would tell you, both pools have performed.

I think that -- we like to think that we have the best mousetrap out there that we have. We're most aggressive on the Internet. We have the best revenue-management systems. But it's tough to comment on how we compare to them.

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

And George, it's Spencer. If I could just make a comment, because this continues to come up.

We have not changed our same-store definition in over a decade. We've been consistent, and I can tell you, in Q3 the same-store properties that have been added in -- which were not primarily lease-up, but rather just properties that we acquired -- provided an uplift of 80 basis points on revenue and 110 basis points on the NOI.

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So if you subtract that out, we're still very pleased with what our properties are producing, our platform enables us to do, and probably most importantly, what our team is executing on. I think it's a combination of people, platform, and properties that have allowed us to produce the results that we have produced.

George Hoglund - *Jefferies - Analyst*

Thanks. And just one more. In terms of markets where you may be -- or, are you seeing in markets somewhat of a push-back on rates, where you're maybe seeing a little bit more of an occupancy decline or -- are you really seeing that anywhere?

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

So even our worst markets, we're still seeing 5% growth. So I think that it's healthy across the US. Markets are somewhat cyclical. Some are better than others. I would tell you our worst markets are probably Chicago and maybe Washington, D.C. But they've been very strong in past years, and they're still experiencing 5% growth.

George Hoglund - *Jefferies - Analyst*

Thanks, guys.

Operator

Ki Bin Kim, Suntrust.

Ki Bin Kim - *Suntrust Robinson Humphrey - Analyst*

Maybe looking for -- I'm not asking for guidance, but we look at the same-store revenue composition this quarter is around 10%, and you said 250 came from occupancy and lower promotions. If we assume that doesn't happen again, just on a go-forward basis, what are a couple factors that you look at to see if -- can you still do 7.5%, or is that pretty much have we hit the ceiling in terms of growth rate? And maybe what has to happen in the economy or population or home prices or things like that, that can change that needle to the positive or negative on that number?

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

So Ki Bin, it's Spencer. First of all, we will push rate on both existing and new customers as hard as we can. We don't want to get ahead of ourselves. There might be another 100 basis points on occupancy.

The overall health of the economy, obviously, will be a big determinant. But as we look at 2016, as Scott said, our expectation is our results are going to go from phenomenal to maybe just really good. And we'll have to see how the year transpires.

But I don't see any disruptive element on the horizon with regard to new supply for the next couple of years, which I already commented on. And I only see us getting more powerful and potent in the digital world, particularly with our mobile strategy. And we're going to continue to invest wisely, and we're going to do everything we can to drive optimal performance from these assets.

Ki Bin Kim - *Suntrust Robinson Humphrey - Analyst*

Have you seen any noticeable change in customer move-out activity based on the rental rate that you're pushing through from previous cycles?

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

No, sir.

Ki Bin Kim - *Suntrust Robinson Humphrey - Analyst*

Okay, thank you.

Operator

Steve Rose, Citigroup.

Steve Rose - *Citigroup - Analyst*

I wanted to ask you -- I know you've mentioned a couple times that you don't see new supply as a big issue over the next couple of years. But when you look at -- I'm just basing this on some commentary from some brokers who I've spoken to that it's actually harder to get lending for new supply in smaller markets than it is for bigger markets. And I'm wondering if you see that at all, and maybe the tenor of lending in general in the space as people try to -- I would think there's got to be a fair amount of capital that's looking to get into this industry and for some reason it's not able to be put to work. I'm wondering if you could talk about what you're seeing on the ground level.

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

From what we're seeing -- it's hard to comment a lot on financing, just because we're not out there looking for it. I think well-capitalized developers are going to be able to get loans.

Obviously, better markets, it's going to be better, but it also probably affects your returns. You know, your returns in New York City are going to be less than your returns in Dallas, you would expect.

The other thing that's happening is land prices, I think, are pricing some people out of certain markets. We have not seen anything substantial out of Southern California, out of San Francisco, out of Seattle, some of these markets where it's difficult -- everybody's competing for the same piece of land.

So from our perspective, we are seeing some new construction. It's more in the markets like Denver, Dallas, Atlanta, South Florida, even some in New York City. But from our perspective, we don't see it across the whole US. We see certain pockets with some, and -- we do expect it to come with the returns of the properties, but I'm not sure it's going to be a tidal wave of new construction.

Steve Rose - *Citigroup - Analyst*

Okay. And can you talk about the average length of stay? Is that continuing to lengthen out?

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

It's about the same. There might be a very, very slight uptick on the length of stay, but it's been very stable [to me].

Steve Rose - *Citigroup - Analyst*

Okay, thank you.

Operator

Varav Meta, Cantor Fitzgerald.

Varav Meta - *Cantor Fitzgerald - Analyst*

Just a quick one on the [lease-up] period. You have a few CofO stores that are under operations now. I was hoping if you can comment on the impact of technology that you're seeing on the time it's taking to lease up those stores.

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

So we are seeing quicker lease-up than our CofO stores. It's probably a combination of technology as well as no new supply. In our supplemental packet, page 23, we showed the details and where the occupancy is for those stores.

We are doing tests on our stores to see if you can move the needle in terms of marketing spend, in terms of rate. But overall, typically we're going to go into the market with lower prices and try to be as aggressive as we can to fill them up as quickly as possible.

Varav Meta - *Cantor Fitzgerald - Analyst*

Okay. And following up on the construction financing, is that the only reason you're seeing an increase in [transfer] merchant builders and other developers to bring CofO deals to you guys, the lack of construction financing, or is there something else going on, as well?

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

So with them bringing CofO deals to us, clearly they're getting some type of financing in the interim. I'm guessing most of them have some type of construction loan. And then potentially this helps, as far as the [take-out].

The other thing that changed in today's cycle for a lot of these developers is, it used to be that they would build the property, they'd open it up, they'd take out a yellow page, they'd operate it themselves.

I think with the sophistication now of the larger players, that's becoming to be more and more difficult. It's difficult to compete on the Internet for a small operator, and many of them are coming to the big, big players to have them manage those properties. Or [at least sell them a] CofO.

Varav Meta - *Cantor Fitzgerald - Analyst*

Okay, thank you.

Operator

John Pawlowski, Green Street Advisors.

John Pawlowski - *Green Street Advisors - Analyst*

The 19 Harrison Street properties saw outsized acceleration in revenue and NOI growth quarter. Can you provide some color on what drove this and whether anything has changed operationally now that these are wholly owned?

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

Nothing's changed operationally. I would tell you it's just timing on those properties. There's nothing significant that's changed, if I recall right. I think those properties, revenue-wise, are operating very similar to many of our existing properties.

John Pawlowski - *Green Street Advisors - Analyst*

Okay, thank you.

Operator

Jonathan Hughes, Raymond James.

Jonathan Hughes - *Raymond James - Analyst*

I'm looking at the 61 stores that were added in the same-store pool. You've been able to increase NOI there by a pretty impressive amount this year, I think something well ahead of 20% the first 9 months. Can you talk about the contribution from those assets versus the 50 basis points guided at the beginning of the year? And then maybe looking ahead, could we expect a similar boost from those properties that get added next year?

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

So if you look at page 18 of our supplemental, it actually compares the last year's 442 pool to this year 503. And in the third quarter, they added 80 basis points to change in pool, and then 100 basis points year to date.

I would tell you that that is a little bit of an anomaly. I think that we would expect a small bump from next year change in pool, but nothing like we've seen this year.

Jonathan Hughes - *Raymond James - Analyst*

Okay. Thanks for that. And then lastly, a broader question. I'm interested to hear your thoughts about valet, or on-demand storage services in some urban markets, like New York, Boston, and DC. Do you see these as competitors to your business, or do you see them as complementary, where they may actually rent units -- the facilities you currently own to store their bins?

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

Lots of questions in there, Jonathan. Valet, or concierge services -- it's obviously something we're looking at. Right now, I'm aware of several dozen players that are all vying to prove this product concept.

One of the things that I do know is, with over 1300 stores scattered across the US, we're in a really good position to be part of the solution. And this is one where we're keeping our options open, seeing how things shake out. We've had numerous discussions, and it's something that is being incubated.

Now, whether it turns out to be a significant part of what happens when people are looking for a solution for storage, only time will tell. But I can tell you, it's not something that we are ignoring. We're very keenly interested in the urban markets, where you have small units in these major markets. And we think that it could have a place.

But the piece of this is much like the pickup and delivery service of years gone by. There's a huge logistical component to it. Real estate is part of the solution, but it's not the entire solution, and we're going to have to be very thoughtful, and as I said, keep our options open.

But, yes, we've been exploring it and trying to understand what the implications might mean for our core market today. It is de minimis. It is insignificant, and it's not impacting our business, as our results would indicate.

Jonathan Hughes - *Raymond James - Analyst*

Okay. Have any of them approached you to maybe try and team up and come up with a solution, or --?

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

We're just keeping all options open, Jonathan.

Jonathan Hughes - *Raymond James - Analyst*

Okay. Fair enough. Thanks, guys.

Operator

Paul Adornato, BMO Capital Markets.

Paul Adornato - *BMO Capital Markets - Analyst*

Most of my questions have been answered, but I was wondering if you could share with us perhaps some -- what's on your plate in terms of R&D, what's next out there? And while we're on the topic, can you talk about your new mobile app and some of the features there?

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

So in terms of R&D, Paul, I'm not at liberty to talk about what we're cooking in the kitchen. Well bring that to light when we're prepared (laughter).

Paul Adornato - *BMO Capital Markets - Analyst*

Fair enough.

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

Mobile -- it's really interesting. I think it was April 21 of this year where Google changed the algorithm. It was called Mobilegeddon. I think our team, perhaps as much as a year in advance, started working on a mobile strategy. And the mobile strategy definitely favors those that actually own the real estate, especially when you look at the maps.

The Mobilegeddon piece with the algorithmic change at Google favored sites that were mobile-friendly. And what I can tell you is, mobile has become the leading search device. It's eclipsed desktop and laptop. And it's a core strategic advantage to this Company.

I don't believe that the smaller operators have the resources to throw at a mobile platform what we and the other national storage operators have been able to do. And I think this is, once again, the Internet creating a landscape of the haves and the have-nots. And that chasm is widening and the rate at which that chasm is widening is accelerating. And I think we're in a great position with the other storage REITs. It's a great time to be a large national operator.

Paul Adornato - *BMO Capital Markets - Analyst*

Great, thanks. And while we're on the topic, what is the cut-off for -- do you consider the four or maybe five public operators as large enough? Or are some of those billion-dollar portfolios large enough to enjoy some of these benefits?

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

It depends on the company and their commitment to technology. There are regional players that are very sophisticated and doing a great job.

But once again, it ultimately comes down to how many dollars do you have to spend on your mobile strategy. And size and scale are a decided advantage in the allocation.

Paul Adornato - *BMO Capital Markets - Analyst*

Thank you.

Operator

(operator instructions) Todd Thomas, KeyBanc Capital Markets.

Todd Thomas - *KeyBanc Capital Markets - Analyst*

With regard to the exclusive you have in managing new acquisitions for strategic, is that an option, like a ROFO, where you say, yes, we will manage the property? Or is it something that, you know, as they acquire, you're sort of required to manage those properties, regardless of where it is and how close it might be to your existing properties, or whether or not it's in markets where you're concentrated?

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

We're going to take them all, Todd. And quite frankly, the more properties we have in the market, the more power we have in that market. And I would much rather have an asset in close proximity to one of our assets that we control pricing and promotion, then having it be in the hands of someone that may not be rational in their behavior.

Todd Thomas - *KeyBanc Capital Markets - Analyst*

Okay. Just one quick followup on the mobile technology. How much of your rental demand is sourced from mobile today? And where was that last year?

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

More than 50%, and last year, it was probably 30%. So the rate of growth is tremendous, and the impact on our business is significant, and we're really pleased that we're ahead of the pack.

Todd Thomas - *KeyBanc Capital Markets - Analyst*

Okay. Thank you.

Operator

Wes Golladay, RBC Capital Markets.

Wes Golladay - *RBC Capital Markets - Analyst*

Great quarter. Sticking with topics such as the structural barriers and Mobilegeddon, are you seeing developers just throwing the towel now, and what is the development pool like versus the last cycle?

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

First of all, the last cycle -- on average through the mid-2000s, Wes, it was more than 2600 properties per year being put into the marketplace.

Today, depending on whose number you want to use, we're at 20%, 30% of that number. And for us, I think that there is a growing awareness amongst the smaller operators and the would be developers that they have the advantage in the local markets when it comes to connections and maybe getting a deal done, but they cannot compete because we're not in the world of yellow pages anymore. We're in the land of digital real estate, and they're recognizing that they don't have the sophistication or the dollars to even attempt to compete against the REITs.

So, yes, I think many, many folks out there are throwing in the towel. And I think that that is going to continue to accelerate.

Wes Golladay - *RBC Capital Markets - Analyst*

Okay. And then you mentioned Denver and Dallas as being markets with supply on the horizon. But a lot of these markets are economically full. So would you expect the initial round of supply to be absorbed by pent-up demand, or is there any markets that concern you, with the first round of supply?

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

I think there was quite a dearth of supply, Wes, 2008, 2009, 2010, 2011. And I think that the supply that's being put into those markets is largely fixing the pent-up problem. So we feel comfortable with the supply issue for the next couple years, as I've a couple times today.

Wes Golladay - *RBC Capital Markets - Analyst*

Okay. And then lastly, you guys have a lot of good consumer data. The economy appears to be softening a little bit at the margin. Are you seeing anything in your data set that is at least a yellow flag for you at the moment?

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

No, sir.

Wes Golladay - *RBC Capital Markets - Analyst*

Okay, thanks a lot.

Operator

I'm showing no further questions. I would like to turn the call back to CEO, Spencer Kirk, for any further remarks.

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

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

Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program, and you may all disconnect. Everyone, have a great day.

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