

Extra Space Storage Inc.
Form 10-Q
May 08, 2012
[Table of Contents](#)

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended March 31, 2012

or

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to .

Commission File Number: 001-32269

EXTRA SPACE STORAGE INC.

(Exact name of registrant as specified in its charter)

Edgar Filing: Extra Space Storage Inc. - Form 10-Q

Maryland

(State or other jurisdiction of incorporation or organization)

20-1076777

(I.R.S. Employer Identification No.)

2795 East Cottonwood Parkway, Suite 400

Salt Lake City, Utah 84121

(Address of principal executive offices)

Registrant's telephone number, including area code: **(801) 365-4600**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☒

Accelerated filer ☐

Non-accelerated filer ☐

Smaller reporting company ☐

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

The number of shares outstanding of the registrant's common stock, par value \$0.01 per share, as of April 30, 2012, was 103,860,494.

Table of Contents

EXTRA SPACE STORAGE INC.

TABLE OF CONTENTS

<u>STATEMENT ON FORWARD-LOOKING INFORMATION</u>	3
<u>PART I. FINANCIAL INFORMATION</u>	4
<u>ITEM 1. FINANCIAL STATEMENTS</u>	4
<u>NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS</u> <u>(unaudited)</u>	10
<u>ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL</u> <u>CONDITION AND RESULTS OF OPERATIONS</u>	20
<u>ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET</u> <u>RISK</u>	31
<u>ITEM 4. CONTROLS AND PROCEDURES</u>	31
<u>PART II. OTHER INFORMATION</u>	32
<u>ITEM 1. LEGAL PROCEEDINGS</u>	32
<u>ITEM 1A. RISK FACTORS</u>	32
<u>ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF</u> <u>PROCEEDS</u>	32
<u>ITEM 3. DEFAULTS UPON SENIOR SECURITIES</u>	32
<u>ITEM 4. MINE SAFETY DISCLOSURES</u>	32
<u>ITEM 5. OTHER INFORMATION</u>	32
<u>ITEM 6. EXHIBITS</u>	32
<u>SIGNATURES</u>	34

Table of Contents

STATEMENT ON FORWARD-LOOKING INFORMATION

Certain information set forth in this report contains forward-looking statements within the meaning of the federal securities laws. Forward-looking statements include statements concerning our plans, objectives, goals, strategies, future events, future revenues or performance, capital expenditures, financing needs, plans or intentions relating to acquisitions and other information that is not historical information. In some cases, forward-looking statements can be identified by terminology such as believes, expects, estimates, may, will, should, anticipates, or the negative of such terms or other comparable terminology, or by discussions of strategy. We may also make additional forward-looking statements from time to time. All such subsequent forward-looking statements, whether written or oral, by us or on our behalf, are also expressly qualified by these cautionary statements.

All forward-looking statements, including without limitation, management's examination of historical operating trends and estimate of future earnings, are based upon our current expectations and various assumptions. Our expectations, beliefs and projections are expressed in good faith and we believe there is a reasonable basis for them, but there can be no assurance that management's expectations, beliefs and projections will result or be achieved. All forward-looking statements apply only as of the date made. We undertake no obligation to publicly update or revise forward-looking statements which may be made to reflect events or circumstances after the date made or to reflect the occurrence of unanticipated events.

There are a number of risks and uncertainties that could cause our actual results to differ materially from the forward-looking statements contained in or contemplated by this report. Any forward-looking statements should be considered in light of the risks referenced in Part II. Item 1A. Risk Factors below and in Part I. Item 1A. Risk Factors included in our most recent Annual Report on Form 10-K. Such factors include, but are not limited to:

- adverse changes in general economic conditions, the real estate industry and the markets in which we operate;
- the effect of competition from new and existing self-storage facilities or other storage alternatives, which could cause rents and occupancy rates to decline;
- difficulties in our ability to evaluate, finance, complete and integrate acquisitions and developments successfully and to lease up those properties, which could adversely affect our profitability;
- potential liability for uninsured losses and environmental contamination;
- the impact of the regulatory environment as well as national, state, and local laws and regulations including, without limitation, those governing real estate investment trusts (REITs), which could increase our expenses and reduce our cash available for distribution;

Edgar Filing: Extra Space Storage Inc. - Form 10-Q

- disruptions in credit and financial markets and resulting difficulties in raising capital or obtaining credit at reasonable rates or at all, which could impede our ability to grow;
- increased interest rates and operating costs;
- reductions in asset valuations and related impairment charges;
- the failure of our joint venture partners to fulfill their obligations to us or their pursuit of actions that are inconsistent with our objectives;
- the failure to maintain our REIT status for federal income tax purposes;
- economic uncertainty due to the impact of war or terrorism, which could adversely affect our business plan; and
- difficulties in our ability to attract and retain qualified personnel and management members.

[Table of Contents](#)**PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****Extra Space Storage Inc.****Condensed Consolidated Balance Sheets**

(amounts in thousands, except share data)

	March 31, 2012 (unaudited)	December 31, 2011
Assets:		
Real estate assets, net	\$ 2,266,536	\$ 2,263,795
Investments in real estate ventures	125,336	130,410
Cash and cash equivalents	37,575	26,484
Restricted cash	24,273	25,768
Receivables from related parties and affiliated real estate joint ventures	15,415	18,517
Other assets, net	54,001	51,276
Total assets	\$ 2,523,136	\$ 2,516,250
Liabilities, Noncontrolling Interests and Equity:		
Notes payable	\$ 1,025,923	\$ 937,001
Notes payable to trusts	119,590	119,590
Exchangeable senior notes	87,663	87,663
Premium on notes payable	4,273	4,402
Lines of credit	135,000	215,000
Accounts payable and accrued expenses	38,029	45,079
Other liabilities	32,916	33,754
Total liabilities	1,443,394	1,442,489
Commitments and contingencies		
Noncontrolling Interest and Equity:		
Extra Space Storage Inc. stockholders' equity:		
Preferred stock, \$0.01 par value, 50,000,000 shares authorized, no shares issued or outstanding		
Common stock, \$0.01 par value, 300,000,000 shares authorized, 95,042,862 and 94,783,590 shares issued and outstanding at March 31, 2012, and December 31, 2011, respectively		
	950	948
Paid-in capital	1,294,572	1,290,021
Accumulated other comprehensive deficit	(8,142)	(7,936)
Accumulated deficit	(262,874)	(264,086)
Total Extra Space Storage Inc. stockholders' equity	1,024,506	1,018,947
Noncontrolling interest represented by Preferred Operating Partnership units, net of \$100,000 note receivable		
	29,706	29,695
Noncontrolling interests in Operating Partnership	24,425	24,018

Edgar Filing: Extra Space Storage Inc. - Form 10-Q

Other noncontrolling interests	1,105	1,101
Total noncontrolling interests and equity	1,079,742	1,073,761
Total liabilities, noncontrolling interests and equity	\$ 2,523,136	\$ 2,516,250

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents**Extra Space Storage Inc.****Condensed Consolidated Statements of Operations**

(amounts in thousands, except share data)

(unaudited)

	For the Three Months Ended March 31,	
	2012	2011
Revenues:		
Property rental	\$ 75,844	\$ 61,490
Management and franchise fees	6,586	5,967
Tenant reinsurance	8,557	7,024
Total revenues	90,987	74,481
Expenses:		
Property operations	26,596	23,344
Tenant reinsurance	1,848	1,615
Acquisition related costs	609	249
General and administrative	12,640	11,658
Depreciation and amortization	16,524	13,585
Total expenses	58,217	50,451
Income from operations	32,770	24,030
Interest expense	(18,071)	(16,414)
Non-cash interest expense related to amortization of discount on exchangeable senior notes	(444)	(428)
Interest income	275	182
Interest income on note receivable from Preferred Operating Partnership unit holder	1,213	1,213
Income before equity in earnings of real estate ventures and income tax expense	15,743	8,583
Equity in earnings of real estate ventures	2,296	1,811
Equity in earnings of real estate ventures - gain on sale of real estate assets	5,429	
Income tax expense	(950)	(254)
Net income	22,518	10,140
Net income allocated to Preferred Operating Partnership noncontrolling interests	(1,649)	(1,532)
Net income allocated to Operating Partnership and other noncontrolling interests	(655)	(307)
Net income attributable to common stockholders	\$ 20,214	\$ 8,301
Net income per common share		
Basic	\$ 0.21	\$ 0.09
Diluted	\$ 0.21	\$ 0.09
Weighted average number of shares		
Basic	94,888,078	88,045,951
Diluted	99,927,352	92,812,067
Cash dividends paid per common share	\$ 0.20	\$ 0.14

Edgar Filing: Extra Space Storage Inc. - Form 10-Q

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

Extra Space Storage Inc.

Condensed Consolidated Statements of Comprehensive Income

(amounts in thousands)

(unaudited)

	For the Three Months Ended March 31,	
	2012	2011
Net income	\$ 22,518	\$ 10,140
Other comprehensive income:		
Change in fair value of interest rate swaps	(215)	1,163
Comprehensive income	22,303	11,303
Less: comprehensive income (loss) attributable to noncontrolling interest	2,295	1,893
Comprehensive income attributable to common stockholders	\$ 20,008	\$ 9,410

See accompanying notes to unaudited condensed consolidated financial statements.

[Table of Contents](#)
Extra Space Storage Inc.
Condensed Consolidated Statement of Equity

(amounts in thousands, except share data)

(unaudited)

	Noncontrolling Interests			Extra Space Storage Inc. Stockholders' Equity					
	Preferred Operating Partnership	Operating Partnership	Other	Shares	Par Value	Paid-in Capital	Accumulated Other Comprehensive Deficit	Accumulated Deficit	Total Equity
Balances at December 31, 2011	\$ 29,695	\$ 24,018	\$ 1,101	94,783,590	\$ 948	\$ 1,290,021	\$ (7,936)	\$ (264,086)	\$ 1,073,761
Issuance of common stock upon the exercise of options				198,541	2	2,442			2,444
Restricted stock grants issued				73,050					
Restricted stock grants cancelled				(12,319)					
Compensation expense related to stock-based awards						957			957
New issuance of Operating Partnership units		377							377
Net income	1,649	651	4					20,214	22,518
Other comprehensive income	(2)	(7)					(206)		(215)
Tax effect from vesting of restricted stock grants and stock option exercises						1,152			1,152
Distributions to Operating Partnership units held by noncontrolling interests	(1,636)	(614)							(2,250)
Dividends paid on common stock at \$0.20 per share								(19,002)	(19,002)
Balances at March 31, 2012	\$ 29,706	\$ 24,425	\$ 1,105	95,042,862	\$ 950	\$ 1,294,572	\$ (8,142)	\$ (262,874)	\$ 1,079,742

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents**Extra Space Storage Inc.****Condensed Consolidated Statements of Cash Flows**

(amounts in thousands)

(unaudited)

	For the Three Months Ended March 31,	
	2012	2011
Cash flows from operating activities:		
Net income	\$ 22,518	\$ 10,140
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	16,524	13,585
Amortization of deferred financing costs	2,246	1,102
Non-cash interest expense related to amortization of discount on exchangeable senior notes	444	428
Non-cash reduction in interest expense related to amortization of premium on note payable	(316)	
Compensation expense related to stock-based awards	957	1,126
Distributions from real estate ventures in excess of earnings	589	1,313
Changes in operating assets and liabilities:		
Receivables from related parties and affiliated real estate joint ventures	3,102	549
Other assets	2,979	3,110
Accounts payable and accrued expenses	(5,250)	123
Other liabilities	(3,003)	(1,474)
Net cash provided by operating activities	40,790	30,002
Cash flows from investing activities:		
Acquisition of real estate assets	(17,549)	(3,811)
Development and construction of real estate assets	(946)	(3,431)
Investments in real estate ventures	(356)	(3,077)
Return of investment in real estate ventures	1,492	
Change in restricted cash	1,495	(10,029)
Purchase of equipment and fixtures	(531)	(309)
Net cash used in investing activities	(16,395)	(20,657)
Cash flows from financing activities:		
Proceeds from notes payable and lines of credit	206,970	108,858
Principal payments on notes payable and lines of credit	(198,048)	(114,995)
Deferred financing costs	(3,418)	(1,555)
Net proceeds from exercise of stock options	2,444	8,558
Dividends paid on common stock	(19,002)	(12,381)
Distributions to noncontrolling interests	(2,250)	(2,025)
Net cash used in financing activities	(13,304)	(13,540)
Net increase (decrease) in cash and cash equivalents	11,091	(4,195)
Cash and cash equivalents, beginning of the period	26,484	46,750
Cash and cash equivalents, end of the period	\$ 37,575	\$ 42,555

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

Extra Space Storage Inc.

Condensed Consolidated Statements of Cash Flows

(amounts in thousands)

(unaudited)

	For the Three Months Ended March 31,	
	2012	2011
Supplemental schedule of cash flow information		
Interest paid, net of amounts capitalized	\$ 14,705	\$ 14,180
Supplemental schedule of noncash investing and financing activities:		
Redemption of Operating Partnership units held by noncontrolling interests for common stock:		
Noncontrolling interests in Operating Partnership	\$	\$ 1,198
Common stock and paid-in capital		(1,198)
Tax effect from vesting of restricted stock grants and stock option exercises		
Other assets	\$ 1,152	\$ 1,490
Paid-in capital	(1,152)	(1,490)
Acquisitions of real estate assets		
Real estate assets, net	\$ 377	\$ 4,800
Notes payable assumed		(4,800)
Operating Partnership units issued	(377)	
Sale of interest in real estate venture		
Other assets - note receivable	\$ 3,349	\$
Investments in real estate ventures	(3,349)	

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

EXTRA SPACE STORAGE INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

Amounts in thousands, except property and share data

1. ORGANIZATION

Extra Space Storage Inc. (the "Company") is a self-administered and self-managed real estate investment trust ("REIT"), formed as a Maryland corporation on April 30, 2004, to own, operate, manage, acquire, develop and redevelop professionally managed self-storage facilities located throughout the United States. The Company continues the business of Extra Space Storage LLC and its subsidiaries, which had engaged in the self-storage business since 1977. The Company's interest in its properties is held through its operating partnership, Extra Space Storage LP (the "Operating Partnership"), which was formed on May 5, 2004. The Company's primary assets are general partner and limited partner interests in the Operating Partnership. This structure is commonly referred to as an umbrella partnership REIT ("UPREIT"). The Company has elected to be taxed as a REIT under the Internal Revenue Code of 1986, as amended. To the extent the Company continues to qualify as a REIT, it will not be subject to tax, with certain limited exceptions, on the taxable income that is distributed to its stockholders.

The Company invests in self-storage facilities by acquiring or developing wholly-owned facilities or by acquiring an equity interest in real estate entities. At March 31, 2012, the Company had direct and indirect equity interests in 699 operating storage facilities. In addition, the Company managed 183 properties for franchisees and third parties, bringing the total number of operating properties which it owns and/or manages to 882. These properties are located in 34 states and Washington, D.C.

The Company operates in three distinct segments: (1) property management, acquisition and development; (2) rental operations; and (3) tenant reinsurance. The Company's property management, acquisition and development activities include managing, acquiring, developing and selling self-storage facilities. The rental operations activities include rental operations of self-storage facilities. No single tenant accounts for more than 5% of rental income. Tenant reinsurance activities include the reinsurance of risks relating to the loss of goods stored by tenants in the Company's self storage facilities.

2. BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements of the Company are presented on the accrual basis of accounting in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial information and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they may not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (including normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three months ended March 31, 2012, are not necessarily indicative of results that may be expected for the year ended December 31, 2012. The condensed consolidated balance sheet as of December 31, 2011, has been derived from the Company's audited financial statements as of that date, but does not include all of the information and footnotes required by GAAP for complete financial statements. For further information refer to the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011, as filed with the Securities and Exchange Commission.

3. FAIR VALUE DISCLOSURES*Assets and Liabilities Measured at Fair Value on a Recurring Basis*

The following table provides information for each major category of assets and liabilities that are measured at fair value on a recurring basis:

Description	March 31, 2012	Fair Value Measurements at Reporting Date Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Other liabilities - Cash Flow Hedge Swap Agreements	\$ (8,526)	\$	\$ (8,526)	\$

The fair value of our derivatives is based on quoted market prices of similar instruments from various banking institutions or an independent third-party provider for similar instruments. In determining the fair value, we consider our non-performance risk and that of our counterparties.

Table of Contents

There were no transfers of assets and liabilities between Level 1 and Level 2 during the three months ended March 31, 2012. The Company did not have any significant assets or liabilities that are re-measured on a recurring basis using significant unobservable inputs (Level 3) for the three months ended March 31, 2012.

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

Long-lived assets held for use are evaluated for impairment when events or circumstances indicate there may be impairment. The Company reviews each self-storage facility at least annually to determine if any such events or circumstances have occurred or exist. The Company focuses on facilities where occupancy and/or rental income have decreased by a significant amount. For these facilities, the Company determines whether the decrease is temporary or permanent and whether the facility will likely recover the lost occupancy and/or revenue in the short term. In addition, the Company carefully reviews facilities in the lease-up stage and compares actual operating results to original projections.

When the Company determines that an event that may indicate impairment has occurred, the Company compares the carrying value of the related long-lived assets to the undiscounted future net operating cash flows attributable to the assets. An impairment loss is recorded if the net carrying value of the assets exceeds the undiscounted future net operating cash flows attributable to the assets. The impairment loss recognized equals the excess of net carrying value over the related fair value of the assets.

When real estate assets are identified by management as held for sale, the Company discontinues depreciating the assets and estimates the fair value of the assets, net of selling costs. If the estimated fair value, net of selling costs, of the assets that have been identified as held for sale is less than the net carrying value of the assets, then a valuation allowance is established. The operations of assets held for sale or sold during the period are generally presented as discontinued operations for all periods presented.

The Company assesses whether there are any indicators that the value of its investments in unconsolidated real estate ventures may be impaired annually and when events or circumstances indicate there may be impairment. An investment is impaired if management's estimate of the fair value of the investment is less than its carrying value. To the extent impairment has occurred, and is considered to be other than temporary, the loss is measured as the excess of the carrying amount over the fair value of the investment.

In connection with the Company's acquisition of self-storage facilities, the purchase price is allocated to the tangible and intangible assets and liabilities acquired based on their fair values, which are estimated using significant unobservable inputs. The value of the tangible assets, consisting of land and buildings, is determined as if vacant. Intangible assets, which represent the value of existing tenant relationships, are recorded at their fair values based on the avoided cost to replace the current leases. The Company measures the value of tenant relationships based on the rent lost due to the amount of time required to replace existing customers, which is based on the Company's historical experience with turnover in its facilities. Debt assumed as part of an acquisition is recorded at fair value based on current interest rates compared to contractual rates. Acquisition-related transaction costs are expensed as incurred.

Fair Value of Financial Instruments

Edgar Filing: Extra Space Storage Inc. - Form 10-Q

The carrying values of cash and cash equivalents, restricted cash, receivables, other financial instruments included in other assets, accounts payable and accrued expenses, variable rate notes payable, lines of credit and other liabilities reflected in the condensed consolidated balance sheets at March 31, 2012 and December 31, 2011 approximate fair value. The fair values of the Company's notes receivable, fixed rate notes payable and notes payable to trusts and exchangeable senior notes are as follows:

	March 31, 2012		December 31, 2011	
	Fair Value	Carrying Value	Fair Value	Carrying Value
Note receivable from Preferred Operating Partnership unit holder	\$ 104,682	\$ 100,000	\$ 104,049	\$ 100,000
Fixed rate notes payable and notes payable to trusts	\$ 1,078,554	\$ 1,001,099	\$ 1,008,039	\$ 938,681
Exchangeable senior notes	\$ 87,663	\$ 87,663	\$ 92,265	\$ 87,663

4. NET INCOME PER COMMON SHARE

Basic net income per common share is computed by dividing net income by the weighted average common shares outstanding, including unvested share based payment awards that contain a non-forfeitable right to dividends or dividend equivalents. Diluted earnings per common share measures the performance of the Company over the reporting period while giving effect to all potential common shares that were dilutive and outstanding during the period. The denominator includes the weighted average number of basic

Edgar Filing: Extra Space Storage Inc. - Form 10-Q

Table of Contents

shares and the number of additional common shares that would have been outstanding if the potential common shares that were dilutive had been issued, and is calculated using either the treasury stock or as if-converted method. Potential common shares are securities (such as options, convertible debt, exchangeable Series A Participating Redeemable Preferred Operating Partnership units (Preferred OP units) and exchangeable Operating Partnership units (OP units)) that do not have a current right to participate in earnings but could do so in the future by virtue of their option or conversion right. In computing the dilutive effect of convertible securities, net income is adjusted to add back any changes in earnings in the period associated with the convertible security. The numerator also is adjusted for the effects of any other non-discretionary changes in income or loss that would result from the assumed conversion of those potential common shares. In computing diluted earnings per share, only potential common shares that are dilutive (those that reduce earnings per share) are included.

The Company's Operating Partnership had \$87,663 of exchangeable senior notes (the Notes) issued and outstanding as of March 31, 2012, that also could potentially have a dilutive effect on its earnings per share calculations as of that date. The Notes were exchangeable by holders into shares of the Company's common stock under certain circumstances per the terms of the indenture governing the Notes. The exchange price was \$23.20 per share at March 31, 2012. The Company irrevocably agreed to pay only cash for the accreted principal amount of the Notes relative to its exchange obligations, but retained the right to satisfy the exchange obligations in excess of the accreted principal amount in cash and/or common stock. Though the Company retained that right, Accounting Standards Codification (ASC) 260, *Earnings Per Share*, requires an assumption that shares will be used to pay the exchange obligations in excess of the accreted principal amount, and requires that those shares be included in the Company's calculation of weighted average common shares outstanding for the diluted earnings per share computation. For the three months ended March 31, 2012, 455,552 shares related to the Notes were included in the computation for diluted earnings per share as the stock price during this time exceeded the exchange price. No shares were included for the three months ended March 31, 2011 as the stock price during this time did not exceed the exchange price.

For the purposes of computing the diluted impact on earnings per share of the potential conversion of Preferred OP units into common shares, where the Company has the option to redeem in cash or shares and where the Company has stated the positive intent and ability to settle at least \$115,000 of the instrument in cash (or net settle a portion of the Preferred OP units against the related outstanding note receivable), only the amount of the instrument in excess of \$115,000 is considered in the calculation of shares contingently issuable for the purposes of computing diluted earnings per share as allowed by ASC 260-10-45-46.

For the three months ended March 31, 2012 and 2011, options to purchase 32,612 and 290,819 shares of common stock, respectively, were excluded from the computation of earnings per share as their effect would have been anti-dilutive. All restricted stock grants have been included in basic and diluted shares outstanding because such shares earn a non-forfeitable dividend and carry voting rights.

The computation of net income per common share is as follows:

	For the Three Months Ended March 31,			
	2012		2011	
Net income attributable to common stockholders	\$	20,214	\$	8,301
Add: Income allocated to noncontrolling interest - Preferred Operating Partnership and Operating Partnership		2,300		1,844
Subtract: Fixed component of income allocated to noncontrolling interest - Preferred Operating Partnership		(1,438)		(1,438)
Net income for diluted computations	\$	21,076	\$	8,707
Weighted average common shares outstanding:				
Average number of common shares outstanding - basic		94,888,078		88,045,951

Edgar Filing: Extra Space Storage Inc. - Form 10-Q

Operating Partnership units	3,064,128	3,206,963
Preferred Operating Partnership units	989,980	989,980
Shares related to Exchangeable Senior Notes, dilutive and cancelled stock options	985,166	569,173
Average number of common shares outstanding - diluted	99,927,352	92,812,067
Net income per common share		
Basic	\$ 0.21	\$ 0.09
Diluted	\$ 0.21	\$ 0.09

Table of Contents

5. PROPERTY ACQUISITIONS

The following table summarizes the Company's acquisitions of operating properties for the three months ended March 31, 2012, and does not include improvements made to existing assets:

Property Location	Number of Properties	Date of Acquisition	Consideration Paid				Number of OP Units	Number of OP Units	Acquisition Date Fair Value				Closing costs -	Source of Acquisition
			Total Paid	Cash Paid	Assumed	Liability			Land	Building	Intangible	Expensed		
Texas	1	2/29/2012	\$ 9,405	\$ 9,323	\$ 82	\$ -	377	14,193	\$ 1,036	\$ 8,133	\$ 187	\$ 49		Unrelated third party
Maryland	1	3/7/2012	6,284	5,886	21	377	14,193	465	5,600	128	91			Unrelated third party

6. VARIABLE INTERESTS

The Company has interests in two unconsolidated joint ventures with unrelated third parties which are variable interest entities (VIEs or the VIEs). The Company holds 18% and 39% of the equity interests in the VIEs, and has 50% of the voting rights in each of the VIEs. Qualification as a VIE was based on the determination that the equity investments at risk for each of these joint ventures were not sufficient based on a qualitative and quantitative analysis performed by the Company. The Company performed a qualitative analysis for these joint ventures to determine which party was the primary beneficiary of each VIE. The Company determined that since the powers to direct the activities most significant to the economic performance of these entities are shared equally by the Company and its joint venture partners, there is no primary beneficiary. Accordingly, these interests are recorded using the equity method.

The VIEs each own a single self-storage property. These joint ventures are financed through a combination of (1) equity contributions from the Company and its joint venture partners, (2) mortgage notes payable and (3) payables to the Company. The payables to the Company consist of amounts owed for expenses paid on behalf of the joint ventures by the Company as manager and mortgage notes payable to the Company. The Company performs management services for the VIEs in exchange for a management fee of approximately 6% of cash collected by the properties. Except as disclosed, the Company has not provided financial or other support during the periods presented to the VIEs that it was not previously contractually obligated to provide.

The Company guarantees the mortgage notes payable for the VIEs. The Company's maximum exposure to loss for these joint ventures as of March 31, 2012 is the total of the guaranteed loan balances, the payables due to the Company and the Company's investment balances in the joint ventures. The Company believes that the risk of incurring a material loss as a result of having to perform on the loan guarantees is unlikely and, therefore, no liability has been recorded related to these guarantees. Also, repossessing and/or selling the self-storage facility and land that collateralize the loans could provide funds sufficient to reimburse the Company. Additionally, the Company believes the payables to the Company are collectible.

The following table compares the Company's liability balance to the respective VIEs and the maximum exposure to loss related to the VIEs as of March 31, 2012, after netting such liability balance:

Edgar Filing: Extra Space Storage Inc. - Form 10-Q

	Liability Balance	Investment Balance	Balance of Guaranteed Loan	Payables to Company	Maximum Exposure to Loss	Difference
Extra Space of Montrose Avenue LLC	\$	\$ 1,181	\$ 5,120	\$ 2,195	\$ 8,496	\$ (8,496)
Extra Space of Sacramento One LLC		(942)	4,307	6,122	9,487	(9,487)
	\$	\$ 239	\$ 9,427	\$ 8,317	\$ 17,983	\$ (17,983)

The Operating Partnership has three wholly-owned unconsolidated subsidiaries (Trust, Trust II and Trust III, together, the Trusts) that have issued trust preferred securities to third parties and common securities to the Operating Partnership. The proceeds from the sale of the preferred and common securities were loaned in the form of notes to the Operating Partnership. The Trusts are VIEs because the holders of the equity investment at risk (the trust preferred securities) do not have the power to direct the activities of the entities that most significantly affect the entities' economic performance because of their lack of voting or similar rights. Because the Operating Partnership's investment in the Trusts common securities was financed directly by the Trusts as a result of its loan of the proceeds to the Operating Partnership, that investment is not considered to be an equity investment at risk. The Operating Partnership's investment in the Trusts is not a variable interest because equity interests are variable interests only to the extent that the investment is considered to be at risk, and therefore the Operating Partnership cannot be the primary beneficiary of the Trusts. Since the Company is not the primary beneficiary of the Trusts, they have not been consolidated. A debt obligation has been recorded in the form of notes for the proceeds as discussed above, which are owed to the Trusts. The Company has also included its investment in the Trusts' common securities in other assets on the condensed consolidated balance sheets.

Table of Contents

The Company has not provided financing or other support during the periods presented to the Trusts that it was not previously contractually obligated to provide. The Company's maximum exposure to loss as a result of its involvement with the Trusts is equal to the total amount of the notes discussed above less the amounts of the Company's investments in the Trusts' common securities. The net amount is the notes payable that the Trusts owe to third parties for their investments in the Trusts' preferred securities.

The following is a tabular comparison of the liabilities the Company has recorded as a result of its involvement with the Trusts to the maximum exposure to loss the Company is subject to as a result of such involvement as of March 31, 2012:

	Notes payable to Trusts	Investment Balance	Maximum exposure to loss	Difference
Trust	\$ 36,083	\$ 1,083	\$ 35,000	\$
Trust II	42,269	1,269	41,000	
Trust III	41,238	1,238	40,000	
	\$ 119,590	\$ 3,590	\$ 116,000	\$

The Company had no consolidated VIEs during the three months ended March 31, 2012 or 2011.

7. DERIVATIVES

GAAP requires the recognition of all derivative instruments as either assets or liabilities on the balance sheet at fair value. The accounting for changes in fair value of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and further, on the type of hedging relationship. A company must designate each qualifying hedging instrument, based upon the exposure being hedged, as a fair value hedge, cash flow hedge, or a hedge of a net investment in foreign operations.

The Company is exposed to certain risks relating to its ongoing business operations. The primary risk managed by using derivative instruments is interest rate risk. Interest rate swaps are entered into to manage interest rate risk associated with the Company's fixed and variable-rate borrowings. The Company designates certain interest rate swaps as cash flow hedges of variable-rate borrowings and the remainder as fair value hedges of fixed-rate borrowings.

For derivatives designated as fair value hedges, changes in the fair value of the derivative and the hedged item related to the hedged risk are recognized in the statement of operations. For derivatives designated as cash flow hedges, the effective portion of changes in the fair value of the derivative is initially reported in other comprehensive income, outside of earnings, and subsequently reclassified to earnings when the hedged transaction affects earnings.

The following table summarizes the terms of the Company's eleven derivative financial instruments at March 31, 2012:

Edgar Filing: Extra Space Storage Inc. - Form 10-Q

Hedge Product	Hedge Type	Original Notional Amounts	Strike	Effective Dates	Maturity Dates
Swap Agreements	Cash Flow	\$5,291 - \$63,000	2.24% - 6.98%	2/1/2009 - 3/16/2012	6/30/2013 - 2/28/2019

Monthly interest payments were recognized as an increase or decrease in interest expense as follows:

Type	Classification of Income (Expense)	For the Three Months Ended March 31,	
		2012	2011
Swap Agreements	Interest expense	\$ (1,118)	\$ (970)

Edgar Filing: Extra Space Storage Inc. - Form 10-Q

Table of Contents

Information relating to the gain (loss) recognized on the interest rate swap agreements is as follows:

Type	Gain (loss) recognized in OCI March 31, 2012	Location of amounts reclassified from OCI into income	Gain (loss) reclassified from OCI For the Three Months Ended March 31, 2012
Swap Agreements	\$ (215)	Interest expense	\$ (1,118)

The interest rate swap agreements were highly effective for the three months ended March 31, 2012. The gain (loss) reclassified from other comprehensive income (OCI) in the preceding table represents the effective portion of the Company's cash flow hedges reclassified from OCI to interest expense during the three months ended March 31, 2012.

The balance sheet classification and carrying amounts of the derivative instruments are as follows:

Derivatives designated as hedging instruments:	Asset (Liability) Derivatives			
	March 31, 2012		December 31, 2011	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Swap Agreements	Other liabilities	\$ (8,526)	Other liabilities	\$ (8,311)

8. EXCHANGEABLE SENIOR NOTES

On March 27, 2007, the Company's Operating Partnership issued \$250,000 of 3.625% Exchangeable Senior Notes. The Notes bear interest at 3.625% per annum and contain an exchange settlement feature, which provides that the Notes may, under certain circumstances, be exchangeable for cash (up to the principal amount of the Notes) and, with respect to any excess exchange value, for cash, shares of the Company's common stock or a combination of cash and shares of the Company's common stock at the option of the Operating Partnership.

GAAP requires entities with convertible debt instruments that may be settled entirely or partially in cash upon conversion to separately account for the liability and equity components of the instrument in a manner that reflects the issuer's economic interest cost. The Company, therefore, accounts for the liability and equity components of the Notes separately. The equity component is included in paid-in-capital in stockholders' equity in the condensed consolidated balance sheet, and the value of the equity component is treated as original issue discount for purposes of accounting for the debt component. The discount is being amortized over the period of the debt as additional interest expense.

On March 1, 2012, the Company announced that the holders of the Operating Partnership's then-outstanding \$87,663 principal amount of 3.625% Exchangeable Senior Notes had the right to surrender their Notes for repurchase by the Operating Partnership on April 1, 2012 for 100% of the principal amount of the Notes, pursuant to the holders' rights under the indenture governing the Notes. In addition, the Company announced that the Operating Partnership had given notice of its intention to redeem all of the Notes not otherwise surrendered for repurchase or exchange on April 5, 2012, pursuant to its option under the indenture, at a redemption price of 100% of the principal amount of the Notes, plus accrued and unpaid interest to the redemption date. In connection with the redemption, holders of the Notes had the right to exchange their Notes at an exchange rate of 43.1091 shares of the Company's common stock per \$1,000 principal amount of the Notes surrendered. The exchange

Edgar Filing: Extra Space Storage Inc. - Form 10-Q

price was \$23.20 per share at March 31, 2012. The Notes surrendered for exchange could be settled in cash or a combination of cash and stock, subject to the determination of the Operating Partnership.

As of April 3, 2012, the Company received notice that the holders of the entire \$87,663 principal amount of the Notes had surrendered their Notes for exchange. On April 26, 2012, the Company settled the exchange by paying cash for the principal amount of the Notes, as required by the indenture, and issuing 684,685 shares of common stock for the value in excess of the principal amount.

9. NONCONTROLLING INTEREST REPRESENTED BY PREFERRED OPERATING PARTNERSHIP UNITS

On June 15, 2007, the Operating Partnership entered into a Contribution Agreement with various limited partnerships affiliated with AAAAA Rent-A-Space to acquire ten self-storage facilities (the Properties) in exchange for 989,980 Preferred OP units of the Operating Partnership. The self-storage facilities are located in California and Hawaii.

Table of Contents

On June 25, 2007, the Operating Partnership loaned the holders of the Preferred OP units \$100,000. The note receivable bears interest at 4.85% and is due September 1, 2017. The loan is secured by the borrower's Preferred OP units. The holders of the Preferred OP units can convert up to 114,500 Preferred OP units prior to the maturity date of the loan. If any redemption in excess of 114,500 Preferred OP units occurs prior to the maturity date, the holder of the Preferred OP units is required to repay the loan as of the date of that Preferred OP unit redemption. Preferred OP units are shown on the balance sheet net of the \$100,000 loan because the borrower under the loan receivable is also the holder of the Preferred OP units.

The Operating Partnership entered into a Second Amended and Restated Agreement of Limited Partnership (as subsequently amended, the Partnership Agreement) which provides for the designation and issuance of the Preferred OP units. The Preferred OP units will have priority over all other partnership interests of the Operating Partnership with respect to distributions and liquidation.

Under the Partnership Agreement, Preferred OP units in the amount of \$115,000 bear a fixed priority return of 5% and have a fixed liquidation value of \$115,000. The remaining balance participates in distributions with, and has a liquidation value equal to, that of the common OP units. The Preferred OP units became redeemable at the option of the holder on September 1, 2008, which redemption obligation may be satisfied, at the Company's option, in cash or shares of its common stock.

GAAP requires a company to present ownership interests in subsidiaries held by parties other than the company in the consolidated financial statements within the equity section, but separate from the company's equity. It also requires the amount of consolidated net income attributable to the parent and to the noncontrolling interest to be clearly identified and presented on the face of the consolidated statement of operations and requires changes in ownership interest to be accounted for similarly as equity transactions. If noncontrolling interests are determined to be redeemable, they are to be carried at their redemption value as of the balance sheet date and reported as temporary equity.

The Company has evaluated the terms of the Preferred OP units and classifies the noncontrolling interest represented by the Preferred OP units as stockholders' equity in the accompanying condensed consolidated balance sheets. The Company will periodically evaluate individual noncontrolling interests for the ability to continue to recognize the noncontrolling amount as permanent equity in the condensed consolidated balance sheets. Any noncontrolling interests that fail to qualify as permanent equity will be reclassified as temporary equity and adjusted to the greater of (1) the carrying amount, or (2) its redemption value as of the end of the period in which the determination is made.

10. NONCONTROLLING INTEREST IN OPERATING PARTNERSHIP

The Company's interest in its properties is held through the Operating Partnership. ESS Holding Business Trust I, a wholly-owned subsidiary of the Company, is the sole general partner of the Operating Partnership. The Company, through ESS Holding Business Trust II, a wholly-owned subsidiary of the Company, is also a limited partner of the Operating Partnership. Between its general partner and limited partner interests, the Company held a 95.9% majority ownership interest therein as of March 31, 2012. The remaining ownership interests in the Operating Partnership (including Preferred OP units) of 4.1% are held by certain former owners of assets acquired by the Operating Partnership. As of March 31, 2012, the Operating Partnership had 3,064,128 common OP units outstanding.

The noncontrolling interest in the Operating Partnership represents common OP units that are not owned by the Company. In conjunction with the formation of the Company, and as a result of subsequent acquisitions, certain persons and entities contributing interests in properties to the

Edgar Filing: Extra Space Storage Inc. - Form 10-Q

Operating Partnership received limited partnership units in the form of OP units. Limited partners who received OP units in the formation transactions or in exchange for contributions for interests in properties have the right to require the Operating Partnership to redeem part or all of their common OP units for cash based upon the fair market value of an equivalent number of shares of the Company's common stock (ten-day average) at the time of the redemption. Alternatively, the Company may, at its option, elect to acquire those OP units in exchange for shares of its common stock on a one-for-one basis, subject to anti-dilution adjustments provided in the Partnership Agreement. The ten-day average closing stock price at March 31, 2012, was \$28.12 and there were 3,064,128 common OP units outstanding. Assuming that all of the unit holders exercised their right to redeem all of their common OP units on March 31, 2012, and the Company elected to pay the noncontrolling members cash, the Company would have paid \$86,163 in cash consideration to redeem the OP units.

GAAP requires a company to present ownership interests in subsidiaries held by parties other than the company in the consolidated financial statements within the equity section, but separate from the company's equity. It also requires the amount of consolidated net income attributable to the parent and to the noncontrolling interest to be clearly identified and presented on the face of the consolidated statement of operations and requires changes in ownership interest to be accounted for similarly as equity transactions. If noncontrolling interests are determined to be redeemable, they are to be carried at their redemption value as of the balance sheet date and reported as temporary equity.

Table of Contents

The Company has evaluated the terms of the common OP units and classifies the noncontrolling interest in the Operating Partnership as stockholders' equity in the accompanying condensed consolidated balance sheets. The Company will periodically evaluate individual noncontrolling interests for the ability to continue to recognize the noncontrolling amount as permanent equity in the condensed consolidated balance sheets. Any noncontrolling interests that fail to qualify as permanent equity will be reclassified as temporary equity and adjusted to the greater of (1) the carrying amount, or (2) its redemption value as of the end of the period in which the determination is made.

11. OTHER NONCONTROLLING INTERESTS

Other noncontrolling interests represent the ownership interests of various third parties in three consolidated self-storage properties as of March 31, 2012. Two of these consolidated properties were under development, and one was in the lease-up stage at March 31, 2012. The ownership interests of the third-party owners range from 5.0% to 27.6%. Other noncontrolling interests are included in the stockholders' equity section of the Company's condensed consolidated balance sheet. The income or losses attributable to these third-party owners based on their ownership percentages are reflected in net income allocated to Operating Partnership and other noncontrolling interests in the condensed consolidated statement of operations.

12. EQUITY IN EARNINGS OF REAL ESTATE VENTURES GAIN ON SALE OF JOINT VENTURE REAL ESTATE ASSETS

On January 15, 2012, the Company sold its 40% equity interest in U-Storage de Mexico S.A. and related entities to its joint venture partners for \$4,841. The Company received cash of \$1,492 and a note receivable of \$3,349. No gain or loss was recorded on the sale.

On February 17, 2012, a joint venture in which the Company held a 40% equity interest sold its only self-storage property. The property was located in New York. As a result of the sale, the joint venture was dissolved, and the Company received cash proceeds which resulted in a gain of \$5,429.

13. SEGMENT INFORMATION

The Company operates in three distinct segments: (1) property management, acquisition and development; (2) rental operations; and (3) tenant reinsurance. Financial information for the Company's business segments is set forth below:

	March 31, 2012	December 31, 2011
Balance Sheet		
Investment in real estate ventures		
Rental operations	\$ 125,336	\$ 130,410
Total assets		
Property management, acquisition and development	\$ 238,316	\$ 250,953

Edgar Filing: Extra Space Storage Inc. - Form 10-Q

Rental operations	2,262,113	2,243,441
Tenant reinsurance	22,707	21,856
	\$ 2,523,136	\$ 2,516,250

Edgar Filing: Extra Space Storage Inc. - Form 10-Q

Table of Contents

	For the Three Months Ended March 31,	
	2012	2011
Statement of Operations		
Total revenues		
Property management, acquisition and development	\$ 6,586	\$ 5,967
Rental operations	75,844	61,490
Tenant reinsurance	8,557	7,024
	\$ 90,987	\$ 74,481
Operating expenses, including depreciation and amortization		
Property management, acquisition and development	\$ 14,244	\$ 12,681
Rental operations	42,125	36,155
Tenant reinsurance	1,848	1,615
	\$ 58,217	\$ 50,451
Income (loss) from operations		
Property management, acquisition and development	\$ (7,658)	\$ (6,714)
Rental operations	33,719	25,335
Tenant reinsurance	6,709	5,409
	\$ 32,770	\$ 24,030
Interest expense		
Property management, acquisition and development	\$ (731)	\$ (782)
Rental operations	(17,784)	(16,060)
	\$ (18,515)	\$ (16,842)
Interest income		
Property management, acquisition and development	\$ 272	\$ 179
Tenant reinsurance	3	3
	\$ 275	\$ 182
Interest income on note receivable from Preferred Operating Partnership unit holder		
Property management, acquisition and development	\$ 1,213	\$ 1,213
Equity in earnings of real estate ventures		
Rental operations	\$ 2,296	\$ 1,811
Equity in earnings of real estate ventures-gain on sale of real estate assets		
Property management, acquisition and development	\$ 5,429	\$
Income tax expense		
Property management, acquisition and development	\$ 1,399	\$ 1,640
Tenant reinsurance	(2,349)	(1,894)
	\$ (950)	\$ (254)
Net income (loss)		
Property management, acquisition and development	\$ (76)	\$ (4,464)
Rental operations	18,231	11,086
Tenant reinsurance	4,363	3,518
	\$ 22,518	\$ 10,140
Depreciation and amortization expense		
Property management, acquisition and development	\$ 995	\$ 774
Rental operations	15,529	12,811
	\$ 16,524	\$ 13,585

Edgar Filing: Extra Space Storage Inc. - Form 10-Q

Statement of Cash Flows

Acquisition of real estate assets

Property management, acquisition and development	\$	(17,549)	\$	(3,811)
--------------------------------------------------	----	----------	----	---------

Development and construction of real estate assets

Property management, acquisition and development	\$	(946)	\$	(3,431)
--------------------------------------------------	----	-------	----	---------

Table of Contents**14. COMMITMENTS AND CONTINGENCIES**

The Company has guaranteed loans for unconsolidated joint ventures as follows:

	Date of Guaranty	Loan Maturity Date	Guaranteed Loan Amount	Estimated Fair Value of Assets
Extra Space of Montrose Avenue LLC	Dec-10	Dec-13	\$ 5,120	\$ 8,369
Extra Space of Sacramento One LLC	Apr-09	Apr-14	\$ 4,307	\$ 9,676
ESS Baltimore LLC	Nov-04	Feb-13	\$ 4,011	\$ 6,534

If the joint ventures default on the loans, the Company may be forced to repay the loans. Repossessing and/or selling the self-storage facilities and land that collateralizes the loans could provide funds sufficient to reimburse the Company. The Company has recorded no liability in relation to these guarantees as of March 31, 2012, as the fair value of the guarantees was not material. The Company believes the risk of incurring a material loss as a result of having to perform on these guarantees is unlikely.

The Company has been involved in routine litigation arising in the ordinary course of business. As a result of these litigation matters, the Company has recorded a liability of \$1,800, which is included in other liabilities on the condensed consolidated balance sheets. The Company does not believe that it is reasonably likely that the loss related to these litigation matters will be in excess of the current amount accrued. As of March 31, 2012, the Company was not involved in any material litigation nor, to its knowledge, was any material litigation threatened against it which, in the opinion of management, is expected to have a material adverse effect on the Company's financial condition or results of operations.

15. SUBSEQUENT EVENTS

On April 16, 2012, the Company announced that it will acquire Prudential Real Estate Investors (PREI®) 94.9% interest in the ESS PRISA III LLC joint venture that was formed in 2005. The Company owns the remaining 5.1% interest. The joint venture owns 36 properties located in 18 states. The Company will pay approximately \$298,000 to acquire PREI's interest in the joint venture, consisting of approximately \$160,000 in cash consideration and the assumption of an existing loan of \$145,000, of which \$138,000 relates to PREI's interest. It is anticipated that this transaction will close in July 2012.

On April 20, 2012, the Company issued and sold 8,050,000 shares of common stock in a public offering, including 1,050,000 shares pursuant to the underwriter's full exercise of its option to purchase additional shares of common stock from the Company. Net proceeds of the offering were approximately \$226,900, after deducting the underwriting discount and estimated expenses, which will be used to fund acquisitions, pay down debt and for general corporate and working capital purposes.

Table of Contents

Extra Space Storage Inc.

Management's Discussion and Analysis

Amounts in thousands, except property and share data

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

CAUTIONARY LANGUAGE

The following discussion and analysis should be read in conjunction with our *Unaudited Condensed Consolidated Financial Statements* and the *Notes to Unaudited Condensed Consolidated Financial Statements* appearing elsewhere in this report and the *Consolidated Financial Statements*, *Notes to Consolidated Financial Statements* and *Management's Discussion and Analysis of Financial Condition and Results of Operations* contained in our Form 10-K for the year ended December 31, 2011. We make statements in this section that are forward-looking statements within the meaning of the federal securities laws. For a complete discussion of forward-looking statements, see the section in this Form 10-Q entitled *Statement on Forward-Looking Information*. (Amounts in thousands except property and share data unless otherwise stated).

CRITICAL ACCOUNTING POLICIES

Our discussion and analysis of our financial condition and results of operations are based on our unaudited condensed consolidated financial statements contained elsewhere in this report, which have been prepared in accordance with GAAP. Our notes to the unaudited condensed consolidated financial statements contained elsewhere in this report and the audited financial statements contained in our Form 10-K for the year ended December 31, 2011 describe the significant accounting policies essential to our unaudited condensed consolidated financial statements. Preparation of our financial statements requires estimates, judgments and assumptions. We believe that the estimates, judgments and assumptions that we have used are appropriate and correct based on information available at the time that they were made. These estimates, judgments and assumptions can affect our reported assets and liabilities as of the date of the financial statements, as well as the reported revenues and expenses during the period presented. If there are material differences between these estimates, judgments and assumptions and actual facts, our financial statements may be affected.

In many cases, the accounting treatment of a particular transaction is specifically dictated by GAAP and does not require our judgment in its application. There are areas in which our judgment in selecting among available alternatives would not produce a materially different result, but there are some areas in which our judgment in selecting among available alternatives would produce a materially different result. See the notes to the unaudited condensed consolidated financial statements that contain additional information regarding our accounting policies and other disclosures.

OVERVIEW

Edgar Filing: Extra Space Storage Inc. - Form 10-Q

We are a fully integrated, self-administered and self-managed REIT, formed to continue the business commenced in 1977 by our predecessor companies to own, operate, manage, acquire, develop and redevelop professionally managed self-storage properties. We derive our revenues from rents received from tenants under existing leases at each of our self-storage properties, management fees on the properties we manage for joint venture partners, franchisees and unaffiliated third parties, and our tenant reinsurance program. Our management fee is equal to approximately 6% of total revenues generated by the managed properties.

We operate in competitive markets, often where consumers have multiple self-storage properties from which to choose. Competition has impacted, and will continue to impact, our property results. We experience seasonal fluctuations in occupancy levels, with occupancy levels generally higher in the summer months due to increased moving activity. Our operating results depend materially on our ability to lease available self-storage units and actively manage rental rates, and on the ability of our tenants to make required rental payments. We believe we are able to respond quickly and effectively to changes in local, regional and national economic conditions by centrally adjusting rental rates through the combination of our revenue management team and our industry-leading technology systems.

We continue to evaluate a range of new initiatives and opportunities in order to enable us to maximize stockholder value. Our strategies to maximize stockholder value include the following:

- *Maximize the performance of properties through strategic, efficient and proactive management.* We pursue revenue generating and expense minimizing opportunities in our operations. Our revenue management team seeks to maximize revenue by responding to changing market conditions through our technology system's ability to provide real-time, interactive rental rate and discount management. Our size allows greater ability than the majority of our competitors to implement national, regional and local marketing programs, which we believe will attract more customers to our stores at a lower net cost.

Table of Contents

- *Acquire self-storage properties from strategic partners and third parties.* Our acquisitions team continues to pursue the acquisition of single properties and multi-property portfolios that we believe can provide stockholder value. We have established a reputation as a reliable, ethical buyer, which we believe enhances our ability to negotiate and close acquisitions. In addition, we believe our status as an UPREIT enables flexibility when structuring deals. We continue to see available acquisitions on which to bid and are seeing increasing prices. However, we remain a disciplined buyer and look for acquisitions that will strengthen our portfolio and increase stockholder value.
- *Expand our management business.* Our management business enables us to generate increased revenues through management fees and expand our geographic footprint. This expanded footprint enables us to reduce our operating costs through economies of scale. In addition, we see our management business as a future acquisition pipeline. We pursue strategic relationships with owners that strengthen our acquisition pipeline through agreements that typically give us first right of refusal to purchase the managed property in the event of a potential sale.

Recent U.S. and international market and economic conditions have been challenging, with tighter credit conditions and slower growth. Turbulence in U.S. and international markets and economies may adversely affect our liquidity and financial condition, and the financial condition of our customers. If these market conditions continue, they may result in an adverse effect on our financial condition and results of operations.

PROPERTIES

As of March 31, 2012, we owned or had ownership interests in 699 operating self-storage properties. Of these properties, 359 are wholly-owned and 340 are held in joint ventures. In addition, we managed an additional 183 properties for franchisees or third parties bringing the total number of operating properties that we own and/or manage to 882. These properties are located in 34 states and Washington, D.C. As of March 31, 2012, we owned and/or managed approximately 64 million square feet of space with approximately 585,000 units.

Our properties are generally situated in convenient, highly visible locations clustered around large population centers such as Atlanta, Baltimore/Washington, D.C., Boston, Chicago, Dallas, Houston, Las Vegas, Los Angeles, Miami, New York City, Orlando, Philadelphia, Phoenix, St. Petersburg/Tampa and San Francisco/Oakland. These areas all enjoy above-average population growth and income levels. The clustering of assets around these population centers enables us to reduce our operating costs through economies of scale. Our acquisitions have given us an increased scale in many core markets as well as a foothold in many markets where we had no previous presence.

We consider a property to be in the lease-up stage after it has been issued a certificate of occupancy, but before it has achieved stabilization. We consider a property to be stabilized once it has achieved either an 80% occupancy rate for a full year measured as of January 1, or has been open for three years.

As of March 31, 2012, over 475,000 tenants were leasing storage units at our 882 operating properties that we own and/or manage, primarily on a month-to-month basis, providing the flexibility to increase rental rates over time as markets permit. Although leases are short-term in duration, the typical tenant tends to remain at our properties for an extended period of time. For properties that were stabilized as of March 31, 2012, the median length of stay was approximately 13 months. These existing tenants generally receive rate increases at least annually, for which no direct correlation has been drawn to our vacancy trends. The average annual rent per square foot for our existing customers at these stabilized properties was \$13.43 at March 31, 2012, compared to \$13.25 at March 31, 2011. This compares to our annual rent per square foot for new

Edgar Filing: Extra Space Storage Inc. - Form 10-Q

leases of \$13.18 at March 31, 2012, compared to \$12.62 at March 31, 2011.

Our property portfolio is made up of different types of construction and building configurations depending on the site and the municipality where it is located. Most often sites are what we consider hybrid facilities, a mix of both drive-up buildings and multi-floor buildings. We have a number of multi-floor buildings with elevator access only, and a number of facilities featuring ground-floor access only.

The following table sets forth additional information regarding the occupancy of our stabilized properties by state as of March 31, 2012 and 2011. The information as of March 31, 2011, is on a pro forma basis as though all the properties owned and/or managed at March 31, 2012, were under our control as of March 31, 2011.

[Table of Contents](#)
Stabilized Property Data Based on Location

Location	Number of Properties	Company Number of Units as of March 31, 2012 (1)	Pro forma Number of Units as of March 31, 2011	Company Net Rentable Square Feet as of March 31, 2012 (2)	Pro forma Net Rentable Square Feet as of March 31, 2011	Company Square Foot Occupancy % March 31, 2012	Pro forma Square Foot Occupancy % March 31, 2011
Wholly-owned properties							
Alabama	3	1,391	1,368	172,779	173,869	76.1%	78.7%
Arizona	5	2,791	2,795	356,520	356,520	82.7%	89.2%
California	71	52,975	53,034	5,522,914	5,534,195	84.1%	80.0%
Colorado	10	4,521	4,523	570,636	569,086	89.0%	87.1%
Connecticut	3	1,964	1,978	178,050	177,985	87.5%	88.2%
Florida	32	20,895	21,109	2,239,775	2,247,179	86.3%	80.8%
Georgia	16	8,413	8,415	1,085,709	1,089,254	84.8%	80.7%
Hawaii	2	2,794	2,800	137,969	145,828	85.8%	86.7%
Illinois	11	7,391	7,407	806,239	808,687	86.6%	78.8%
Indiana	8	4,305	4,332	511,034	511,034	88.1%	84.7%
Kansas	1	505	506	50,340	50,310	91.3%	88.3%
Kentucky	4	2,158	2,154	254,065	254,241	87.9%	90.6%
Louisiana	2	1,413	1,412	150,165	150,035	88.9%	85.7%
Maryland	16	11,728	11,713	1,263,038	1,261,165	86.6%	84.3%
Massachusetts	29	17,493	17,526	1,792,506	1,790,122	88.4%	85.6%
Michigan	2	1,027	1,018	135,842	134,674	89.4%	86.8%
Missouri	6	3,154	3,152	374,937	374,962	87.0%	85.3%
Nevada	2	963	965	129,214	129,214	68.5%	68.7%
New Hampshire	2	1,005	1,007	125,473	125,473	86.6%	87.5%
New Jersey	28	22,948	22,968	2,207,912	2,210,191	88.2%	86.9%
New Mexico	1	536	539	71,715	71,475	88.6%	88.2%
New York	13	11,444	11,454	871,851	868,441	88.5%	83.9%
Ohio	14	8,148	8,146	994,204	993,964	83.5%	82.9%
Oregon	1	770	770	103,050	103,130	92.2%	88.9%
Pennsylvania	9	5,718	5,782	655,805	655,735	89.2%	86.8%
Rhode Island	2	1,183	1,191	130,596	131,651	83.1%	81.7%
South Carolina	4	2,157	2,160	253,668	253,406	87.9%	87.3%
Tennessee	3	1,608	1,620	214,260	215,420	83.5%	82.8%
Texas	21	13,436	13,437	1,575,961	1,575,781	84.9%	82.6%
Utah	7	3,194	3,203	409,641	409,547	89.0%	85.6%
Virginia	6	4,293	4,297	416,202	416,552	86.2%	87.6%
Washington	4	2,509	2,540	307,915	308,015	87.6%	71.8%
Total Wholly-Owned Stabilized	338	224,830					