

Extra Space Storage Inc.  
Form 10-Q  
August 05, 2016

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2016

or

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)

Maryland 20-1076777  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) 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  (Do not check if a smaller reporting company) Smaller reporting company

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

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 July 31, 2016, was 125,789,327.

---

Table of Contents

EXTRA SPACE STORAGE INC.

TABLE OF CONTENTS

<u>STATEMENT ON FORWARD-LOOKING INFORMATION</u>	<u>3</u>
<u>PART I. FINANCIAL INFORMATION</u>	<u>4</u>
<u>ITEM 1. FINANCIAL STATEMENTS</u>	<u>4</u>
<u>NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)</u>	<u>10</u>
<u>ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	<u>27</u>
<u>ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	<u>41</u>
<u>ITEM 4. CONTROLS AND PROCEDURES</u>	<u>42</u>
<u>PART II. OTHER INFORMATION</u>	<u>43</u>
<u>ITEM 1. LEGAL PROCEEDINGS</u>	<u>43</u>
<u>ITEM 1A. RISK FACTORS</u>	<u>43</u>
<u>ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS</u>	<u>43</u>
<u>ITEM 3. DEFAULTS UPON SENIOR SECURITIES</u>	<u>43</u>
<u>ITEM 4. MINE SAFETY DISCLOSURES</u>	<u>43</u>
<u>ITEM 5. OTHER INFORMATION</u>	<u>43</u>
<u>ITEM 6. EXHIBITS</u>	<u>43</u>
<u>SIGNATURES</u>	<u>45</u>

## STATEMENT ON FORWARD-LOOKING INFORMATION

Certain information presented 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 “intends,” or the use 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 estimates 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;
- failure to close pending acquisitions on expected terms, or at all;
- the effect of competition from new and existing stores 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 stores, 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”), tenant reinsurance and other aspects of our business, which could adversely affect our results;
- 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;
- the failure to effectively manage our growth and expansion into new markets or to successfully operate acquired properties and operations;
- 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 U.S. 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.

## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

Extra Space Storage Inc.  
Condensed Consolidated Balance Sheets  
(amounts in thousands, except share data)

	June 30, 2016 (Unaudited)	December 31, 2015
Assets:		
Real estate assets, net	\$6,164,787	\$5,689,309
Investments in unconsolidated real estate ventures	99,576	103,007
Cash and cash equivalents	41,058	75,799
Restricted cash	15,232	30,738
Receivables from related parties and affiliated real estate joint ventures	485	2,205
Other assets, net	137,860	170,349
Total assets	\$6,458,998	\$6,071,407
Liabilities, Noncontrolling Interests and Equity:		
Notes payable, net	\$2,985,320	\$2,758,567
Exchangeable senior notes, net	606,422	623,863
Notes payable to trusts, net	117,258	117,191
Lines of credit	88,000	36,000
Accounts payable and accrued expenses	91,188	82,693
Other liabilities	127,593	80,489
Total liabilities	4,015,781	3,698,803
Commitments and contingencies		
Noncontrolling Interests 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, 500,000,000 shares authorized, 125,238,660 and 124,119,531 shares issued and outstanding at June 30, 2016 and December 31, 2015, respectively	1,252	1,241
Additional paid-in capital	2,510,744	2,431,754
Accumulated other comprehensive loss	(53,845 )	(6,352 )
Accumulated deficit	(343,444 )	(337,566 )
Total Extra Space Storage Inc. stockholders' equity	2,114,707	2,089,077
Noncontrolling interest represented by Preferred Operating Partnership units, net of \$120,230 notes receivable	135,167	80,531
Noncontrolling interests in Operating Partnership	193,182	202,834
Other noncontrolling interests	161	162
Total noncontrolling interests and equity	2,443,217	2,372,604
Total liabilities, noncontrolling interests and equity	\$6,458,998	\$6,071,407

See accompanying notes to unaudited condensed consolidated financial statements.



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

Extra Space Storage Inc.  
 Condensed Consolidated Statements of Operations  
 (amounts in thousands, except share data)  
 (unaudited)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2016	2015	2016	2015
<b>Revenues:</b>				
Property rental	\$211,791	\$ 161,024	\$411,279	\$ 309,918
Tenant reinsurance	21,654	17,340	42,209	33,850
Management fees and other income	10,828	7,496	20,188	15,246
<b>Total revenues</b>	<b>244,273</b>	<b>185,860</b>	<b>473,676</b>	<b>359,014</b>
<b>Expenses:</b>				
Property operations	62,430	48,209	123,542	95,453
Tenant reinsurance	3,941	3,283	8,252	6,211
Acquisition related costs and other	3,138	4,554	7,191	5,423
General and administrative	20,512	16,655	43,914	32,904
Depreciation and amortization	43,950	31,552	86,847	61,980
<b>Total expenses</b>	<b>133,971</b>	<b>104,253</b>	<b>269,746</b>	<b>201,971</b>
Income from operations	110,302	81,607	203,930	157,043
Gain on real estate transactions and earnout from prior acquisition	11,358	400	9,814	400
Interest expense	(32,802 )	(22,811 )	(64,161 )	(44,242 )
Non-cash interest expense related to amortization of discount on equity component of exchangeable senior notes	(1,240 )	(696 )	(2,473 )	(1,393 )
Interest income	1,625	428	3,339	1,284
Interest income on note receivable from Preferred Operating Partnership unit holder	1,212	1,212	2,425	2,425
Income before equity in earnings of unconsolidated real estate ventures and income tax expense	90,455	60,140	152,874	115,517
Equity in earnings of unconsolidated real estate ventures	3,358	3,001	6,188	5,651
Equity in earnings of unconsolidated real estate ventures - gain on sale of real estate assets and purchase of joint venture partners' interests	—	—	26,923	2,857
Income tax expense	(3,773 )	(2,185 )	(6,538 )	(4,433 )
<b>Net income</b>	<b>90,040</b>	<b>60,956</b>	<b>179,447</b>	<b>119,592</b>
Net income allocated to Preferred Operating Partnership noncontrolling interests	(3,434 )	(3,007 )	(6,614 )	(5,933 )
Net income allocated to Operating Partnership and other noncontrolling interests	(3,562 )	(2,610 )	(7,197 )	(4,578 )
<b>Net income attributable to common stockholders</b>	<b>\$83,044</b>	<b>\$ 55,339</b>	<b>\$ 165,636</b>	<b>\$ 109,081</b>
<b>Earnings per common share</b>				
Basic	\$0.66	\$ 0.47	\$ 1.33	\$ 0.93
Diluted	\$0.66	\$ 0.47	\$ 1.32	\$ 0.92
<b>Weighted average number of shares</b>				
Basic	124,914,467	116,861,678	124,678,293	116,491,710
Diluted	132,025,915	124,475,890	132,152,519	123,477,241
Cash dividends paid per common share	\$0.78	\$ 0.59	\$ 1.37	\$ 1.06

See accompanying notes to unaudited condensed consolidated financial statements.

5

---



Extra Space Storage Inc.  
 Condensed Consolidated Statements of Comprehensive Income  
 (amounts in thousands)  
 (unaudited)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2016	2015	2016	2015
Net income	\$90,040	\$60,956	\$179,447	\$119,592
Other comprehensive income (loss):				
Change in fair value of interest rate swaps	(18,797 )	6,305	(49,945 )	(288 )
Total comprehensive income	71,243	67,261	129,502	119,304
Less: comprehensive income attributable to noncontrolling interests	6,105	5,941	11,359	10,558
Comprehensive income attributable to common stockholders	\$65,138	\$61,320	\$118,143	\$108,746

See accompanying notes to unaudited condensed consolidated financial statements.

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

Extra Space Storage Inc.

Condensed Consolidated Statement of Noncontrolling Interests and Equity

(amounts in thousands, except share data)

(unaudited)

	Noncontrolling Interests Preferred Operating Partnership						Extra Space Storage Inc. Stockholders' Equity				
	Series A	Series B	Series C	Series D	Operating Partnership	Other	Shares	Par Value	Additional Paid-in Capital	Accumulated Other Comprehensive Loss	Accumulated Other Comprehensive Income
Balances at December 31, 2015	\$14,189	\$41,902	\$10,730	\$13,710	\$202,834	\$162	124,119,531	\$1,241	\$2,431,754	\$(6,352)	\$0
Issuance of common stock upon the exercise of options	—	—	—	—	—	—	22,855	—	313	—	—
Restricted stock grants issued	—	—	—	—	—	—	98,373	—	—	—	—
Restricted stock grants canceled	—	—	—	—	—	—	(5,909)	—	—	—	—
Issuance of common stock, net of offering costs	—	—	—	—	—	—	831,300	9	73,360	—	—
Compensation expense related to stock-based awards	—	—	—	—	—	—	—	—	4,093	—	—
Issuance of Operating Partnership units in conjunction with acquisitions	—	—	—	—	1,405	—	—	—	—	—	—
Redemption of Operating Partnership units for sale of property	—	—	—	—	(7,689)	—	—	—	—	—	—
Redemption of Operating Partnership units for common stock	—	—	—	—	(829)	—	23,570	—	829	—	—

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

Issuance of Preferred D Units in the Operating Partnership in conjunction with acquisitions	—	—	—	55,037	—	—	—	—	—	—	—	
Repurchase of equity portion of 2013 exchangeable senior notes	—	—	—	—	—	—	148,940	2	(872	)	—	
Net income	3,674	1,257	1,218	465	7,198	(1	)	—	—	—	16	
Other comprehensive income (loss)	(332	)	—	—	(2,120	)	—	—	—	—	(47,493	)
Tax effect from vesting of restricted stock grants and stock option exercises	—	—	—	—	—	—	—	—	1,267	—	—	
Distributions to Operating Partnership units held by noncontrolling interests	(3,742	)	(1,258	)	(1,218	)	(465	)	(7,617	)	—	—
Dividends paid on common stock at \$1.37 per share	—	—	—	—	—	—	—	—	—	—	(1	
Balances at June 30, 2016	\$13,789	\$41,901	\$10,730	\$68,747	\$193,182	\$161	125,238,660	\$1,252	\$2,510,744	\$(53,845)	\$(	

See accompanying notes to unaudited condensed consolidated financial statements.

Extra Space Storage Inc.  
Condensed Consolidated Statements of Cash Flows  
(amounts in thousands)  
(unaudited)

	For the Six Months Ended June 30,	
	2016	2015
Cash flows from operating activities:		
Net income	\$ 179,447	\$ 119,592
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	86,847	61,980
Amortization of deferred financing costs	5,617	3,328
Non-cash interest expense related to amortization of discount on equity component of exchangeable senior notes	2,473	1,393
Non-cash interest expense related to amortization of premium on notes payable	(696 )	(1,682 )
Compensation expense related to stock-based awards	4,093	2,795
Gain on sale of real estate assets and purchase of joint venture partners' interests	(26,923 )	(2,857 )
Gain on real estate transactions and earnout from prior acquisition	(9,814 )	(400 )
Distributions from unconsolidated real estate ventures in excess of earnings	1,936	3,459
Changes in operating assets and liabilities:		
Receivables from related parties and affiliated real estate joint ventures	1,720	(1,302 )
Other assets	(1,186 )	(2,961 )
Accounts payable and accrued expenses	(402 )	3,857
Other liabilities	(3,442 )	(3,915 )
Net cash provided by operating activities	239,670	183,287
Cash flows from investing activities:		
Acquisition of real estate assets	(435,298 )	(240,892 )
Development and redevelopment of real estate assets	(14,400 )	(9,926 )
Proceeds from sale of real estate assets	17,582	800
Change in restricted cash	15,506	(179 )
Investment in unconsolidated real estate ventures	(19,309 )	—
Return of investment in unconsolidated real estate ventures	1,318	—
Purchase/issuance of notes receivable	(10,656 )	—
Principal payments received from notes receivable	41,393	—
Purchase of equipment and fixtures	(2,128 )	(2,592 )
Net cash used in investing activities	(405,992 )	(252,789 )
Cash flows from financing activities:		
Proceeds from the sale of common stock, net of offering costs	73,369	416,643
Repurchase of exchangeable senior notes	(22,192 )	—
Proceeds from notes payable and lines of credit	492,880	892,140
Principal payments on notes payable and lines of credit	(222,923 )	(973,656 )
Deferred financing costs	(5,702 )	(3,451 )
Net proceeds from exercise of stock options	313	1,102
Proceeds from termination of interest rate cap	1,650	—
Dividends paid on common stock	(171,514 )	(123,473 )
Distributions to noncontrolling interests	(14,300 )	(11,573 )
Net cash provided by financing activities	131,581	197,732
Net decrease in cash and cash equivalents	(34,741 )	128,230
Cash and cash equivalents, beginning of the period	75,799	47,663

Cash and cash equivalents, end of the period	\$41,058	\$175,893
--	----------	-----------

8

---

	For the Six Months Ended June 30,	
	2016	2015
Supplemental schedule of cash flow information		
Interest paid	\$59,676	\$40,984
Income taxes paid	8,516	1,431
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	\$(829 )	\$(138 )
Common stock and paid-in capital	829	138
Tax effect from vesting of restricted stock grants and option exercises		
Other assets	\$1,267	\$(1,242 )
Paid-in capital	(1,267 )	1,242
Acquisitions of real estate assets		
Real estate assets, net	\$65,960	\$122,132
Operating Partnership units issued	(56,237 )	(106,522 )
Notes payable assumed	(9,723 )	—
Receivables from related parties and affiliated real estate joint ventures	—	(15,610 )
Accrued construction costs and capital expenditures		
Acquisition of real estate assets	\$7,567	\$—
Development and redevelopment of real estate assets	1,298	—
Accounts payable and accrued expenses	(8,865 )	—
Distribution of real estate from investments in unconsolidated real estate ventures		
Real estate assets, net	\$17,261	\$—
Investments in unconsolidated real estate ventures	(17,261 )	—
Disposition of real estate assets		
Real estate assets, net	\$(7,689 )	\$—
Operating Partnership units redeemed	7,689	—

See accompanying notes to unaudited condensed consolidated financial statements.

EXTRA SPACE STORAGE INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

Amounts in thousands, except store and share data, unless otherwise stated

## 1. ORGANIZATION

Extra Space Storage Inc. (the “Company”) is a fully-integrated, 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 properties (“stores”) 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 interests in its stores 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, or 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 stores by acquiring wholly-owned stores or by acquiring an equity interest in real estate entities. At June 30, 2016, the Company had direct and indirect equity interests in 1,035 stores. In addition, the Company managed 377 stores for third parties, bringing the total number of stores which it owns and/or manages to 1,412. These stores are located in 37 states, Washington, D.C. and Puerto Rico.

The Company operates in three distinct segments: (1) rental operations; (2) tenant reinsurance; and (3) property management, acquisition and development. The rental operations activities include rental operations of stores in which we have an ownership interest. No single tenant accounts for more than 5.0% of rental income. Tenant reinsurance activities include the reinsurance of risks relating to the loss of goods stored by tenants in the Company’s stores. The Company’s property management, acquisition and development activities include managing, acquiring, developing and selling stores.

## 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 and six months ended June 30, 2016, are not necessarily indicative of results that may be expected for the year ending December 31, 2016. The condensed consolidated balance sheet as of December 31, 2015 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, 2015, as filed with the Securities and Exchange Commission.

### Recently Issued Accounting Standards

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2014-09, “Revenue from Contracts with Customers,” which amends the guidance for revenue recognition to replace numerous, industry-specific requirements and converges areas under this topic with those of the International

Financial Reporting Standards. ASU 2014-09 outlines a five-step process for customer contract revenue recognition that focuses on transfer of control, as opposed to transfer of risk and rewards. The amendment also requires enhanced disclosures regarding the nature, amount, timing and uncertainty of revenues and cash flows from contracts with customers. ASU 2014-09 was originally effective for reporting periods beginning after December 15, 2016. Entities can transition to the standard either retrospectively or as a cumulative-effect adjustment as of the date of adoption. In July 2015, the FASB approved a one-year deferral of the effective date of the standard. The new standard will now become effective for annual and interim periods beginning after December 15, 2017 with early adoption on the original effective date permitted. The Company has not yet selected a transition method. The Company is currently assessing the impact of the adoption of ASU 2014-09 on the Company's consolidated financial statements.

In February 2015, the FASB issued ASU 2015-02, "Consolidation (Topic 810): Amendments to the Consolidation Analysis." This guidance is effective for annual reporting periods beginning after December 15, 2015, including interim periods within that reporting period. ASU 2015-02 amends the criteria for determining if a service provider possesses a variable interest in a variable interest entity ("VIE"), and eliminates the presumption that a general partner should consolidate a limited



EXTRA SPACE STORAGE INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

Amounts in thousands, except store and share data, unless otherwise stated

partnership. The Company adopted this guidance effective January 1, 2016. The adoption of this guidance did not have a significant impact on the Company's condensed consolidated financial statements.

In April 2015, the FASB issued ASU 2015-05, "Intangibles – Goodwill and Other – Internal-Use Software (Subtopic 350-40) – Customers Accounting for Fees Paid in a Cloud Computing Arrangement," which provides guidance regarding the accounting for fees paid by a customer in cloud computing arrangements. If a cloud computing arrangement includes a software license, the payment of fees should be accounted for in the same manner as the acquisition of other software licenses. If there is no software license, the fees should be accounted for as a service contract. The guidance is effective in fiscal years beginning after December 15, 2015 and early adoption is permitted. An entity can elect to adopt the amendments either (1) prospectively to all arrangements entered into or materially modified after the effective date or (2) retrospectively. The Company adopted this guidance prospectively effective January 1, 2016. The adoption of this guidance did not have a significant impact on the Company's condensed consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)," which requires lessees to recognize the following for all leases (with the exception of short-term leases) at the commencement date: (1) a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Lessor accounting is largely unchanged under ASU 2016-02. The guidance is effective for annual and interim periods beginning after December 15, 2018. The Company is currently assessing the impact of the adoption of ASU 2016-02 on the Company's consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, "Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting." ASU 2016-09 simplifies several aspects of the accounting for employee share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. This ASU is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. Early adoption is permitted. The Company is currently evaluating the new guidance to determine the impact it may have on its consolidated financial statements.

### 3. FAIR VALUE DISCLOSURES

#### Derivative Financial Instruments

Currently, the Company uses interest rate swaps to manage its interest rate risk. The valuation of these instruments is determined using widely accepted valuation techniques, including discounted cash flow analysis on the expected cash flows of each derivative. This analysis reflects the contractual terms of the derivatives, including the period to maturity, and uses observable market-based inputs, including interest rate curves. The fair values of interest rate swaps are determined using the market standard methodology of netting the discounted future fixed cash payments and the discounted expected variable cash receipts. The variable cash receipts are based on an expectation of future interest rates (forward curves) derived from observable market interest rate forward curves.

The Company incorporates credit valuation adjustments to appropriately reflect both its own nonperformance risk and the respective counterparty's nonperformance risk in the fair value measurements. In adjusting the fair value of its derivative contracts for the effect of nonperformance risk, the Company has considered the impact of netting and any applicable credit enhancements, such as collateral postings, thresholds, mutual puts and guarantees. In conjunction with the FASB's fair value measurement guidance, the Company made an accounting policy election to measure the credit risk of its derivative financial instruments that are subject to master netting agreements on a net basis by

counterparty portfolio.

Although the Company has determined that the majority of the inputs used to value its derivatives fall within Level 2 of the fair value hierarchy, the credit valuation adjustments associated with its derivatives utilize Level 3 inputs, such as estimates of current credit spreads to evaluate the likelihood of default by the Company and its counterparties. However, as of June 30, 2016, the Company had assessed the significance of the impact of the credit valuation adjustments on the overall valuation of its derivative positions and determined that the credit valuation adjustments were not significant to the overall valuation of its derivatives. As a result, the Company determined that its derivative valuations in their entirety were classified in Level 2 of the fair value hierarchy.

## EXTRA SPACE STORAGE INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

Amounts in thousands, except store and share data, unless otherwise stated

The table below presents the Company's assets and liabilities measured at fair value on a recurring basis as of June 30, 2016, aggregated by the level in the fair value hierarchy within which those measurements fall.

Description	June 30, 2016	Fair Value Measurements at Reporting Date Using	
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
Other assets - Cash Flow Hedge Swap Agreements	\$36	\$—	\$36
Other liabilities - Cash Flow Hedge Swap Agreements	\$(53,103)	\$—	\$(53,103)

The Company did not have any significant assets or liabilities that are re-measured on a recurring basis using significant unobservable inputs as of June 30, 2016 or December 31, 2015.

#### 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 store at least annually to determine if any such events or circumstances have occurred or exist. The Company focuses on stores where occupancy and/or rental income have decreased by a significant amount. For these stores, the Company determines whether the decrease is temporary or permanent, and whether the store will likely recover the lost occupancy and/or revenue in the short term. In addition, the Company carefully reviews stores 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, the Company would recognize a loss on the assets held for sale. The operations of assets held for sale or sold during the period are presented as part of normal operations for all periods presented. As of June 30, 2016, the Company had one store and one parcel of undeveloped land classified as held for sale. The estimated fair value less selling costs of each of these assets is greater than the carrying value of the assets, and therefore no loss has been recorded.

The Company assesses whether there are any indicators that the value of the Company's investments in unconsolidated real estate ventures may be impaired annually and when events or circumstances indicate that 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 of the investment over the fair value of the investment.

In connection with the Company's acquisition of stores, 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 stores. 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.

## EXTRA SPACE STORAGE INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

Amounts in thousands, except store and share data, unless otherwise stated

## Fair Value of Financial Instruments

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 June 30, 2016 and December 31, 2015 approximate fair value.

The fair values of the Company's notes receivable from Preferred Operating Partnership unit holders and other fixed rate notes receivable were based on the discounted estimated future cash flows of the notes (categorized within Level 3 of the fair value hierarchy); the discount rate used approximated the current market rate for loans with similar maturities and credit quality. The fair values of the Company's fixed-rate notes payable and notes payable to trusts were estimated using the discounted estimated future cash payments to be made on such debt (categorized within Level 3 of the fair value hierarchy); the discount rates used approximated current market rates for loans, or groups of loans, with similar maturities and credit quality. The fair value of the Company's exchangeable senior notes was estimated using an average market price for similar securities obtained from a third party.

The fair values of the Company's fixed-rate assets and liabilities were as follows for the periods indicated:

	June 30, 2016		December 31, 2015	
	Fair Value	Carrying Value	Fair Value	Carrying Value
Notes receivable from Preferred Operating Partnership unit holders	\$ 131,701	\$ 120,230	\$ 128,216	\$ 120,230
Fixed rate notes receivable	\$ 54,825	\$ 53,593	\$ 86,814	\$ 84,331
Fixed rate notes payable and notes payable to trusts	\$ 2,446,724	\$ 2,367,687	\$ 1,828,486	\$ 1,806,904
Exchangeable senior notes	\$ 760,594	\$ 638,172	\$ 770,523	\$ 660,364

## 4. EARNINGS PER COMMON SHARE

Basic earnings per common share is computed using the two-class method by dividing net income attributable to common stockholders by the weighted average number of common shares outstanding during the period. All outstanding unvested restricted stock awards contain rights to non-forfeitable dividends and participate in undistributed earnings with common stockholders; accordingly, they are considered participating securities that are included in the two-class method. 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 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 two-class, treasury stock or as if-converted method, whichever is most dilutive. Potential common shares are securities (such as options, convertible debt, Series A Participating Redeemable Preferred Units ("Series A Units"), Series B Redeemable Preferred Units ("Series B Units"), Series C Convertible Redeemable Preferred Units ("Series C Units"), Series D Redeemable Preferred Units ("Series D Units") and common Operating Partnership units ("OP Units")) that do not have a current right to participate in earnings of the Company but could do so in the future by virtue of their option, redemption 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 common share, only potential common shares that are dilutive

(those that reduce earnings per common share) are included. For the three months ended June 30, 2016 and 2015, options to purchase approximately 39,564 and 44,207 shares of common stock, respectively, and for the six months ended June 30, 2016 and 2015, options to purchase approximately 28,721 and 32,193 shares of common stock, respectively, were excluded from the computation of earnings per share as their effect would have been anti-dilutive.

## EXTRA SPACE STORAGE INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

Amounts in thousands, except store and share data, unless otherwise stated

The following table presents the number of Preferred Operating Partnership units, and the potential common shares, that were excluded from the computation of earnings per share as their effect would have been anti-dilutive, assuming full conversion at the average share price for the quarter of \$90.31.

	For the Three Months Ended June 30,				For the Six Months Ended June 30,			
	2016		2015		2016		2015	
	Number of Units (1)	Equivalent Shares (if converted)	Number of Units (1)	Equivalent Shares (if converted)	Number of Units (1)	Equivalent Shares (if converted)	Number of Units (1)	Equivalent Shares (if converted)
Series B Units	1,676,087	463,982	1,676,087	618,026	1,676,087	472,670	1,676,087	628,124
Series C Units	704,016	328,193	704,016	437,154	704,016	334,338	704,016	444,297
Series D Units	2,749,857	292,443	548,390	202,209	2,749,857	226,285	548,390	205,513
	5,129,960	1,084,618	2,928,493	1,257,389	5,129,960	1,033,293	2,928,493	1,277,934

(1) Represents the number of units outstanding as of the end of the periods presented.

The Operating Partnership had \$63,172 of its 2.375% Exchangeable Senior Notes due 2033 (the “2013 Notes”) issued and outstanding as of June 30, 2016. The 2013 Notes could potentially have a dilutive impact on the Company’s earnings per share calculations. The 2013 Notes are exchangeable by holders into shares of the Company’s common stock under certain circumstances per the terms of the indenture governing the 2013 Notes. The exchange price of the 2013 Notes was \$54.63 per share as of June 30, 2016, and could change over time as described in the indenture. The Company has irrevocably agreed to pay only cash for the accreted principal amount of the 2013 Notes relative to its exchange obligations, but retained the right to satisfy the exchange obligation in excess of the accreted principal amount in cash and/or common stock.

The Operating Partnership had \$575,000 of its 3.125% Exchangeable Senior Notes due 2035 (the “2015 Notes”) issued and outstanding as of June 30, 2016. The 2015 Notes could potentially have a dilutive impact on the Company’s earnings per share calculations. The 2015 Notes are exchangeable by holders into shares of the Company’s common stock under certain circumstances per the terms of the indenture governing the 2015 Notes. The exchange price of the 2015 Notes was \$95.19 per share as of June 30, 2016, and could change over time as described in the indenture. The Company has irrevocably agreed to pay only cash for the accreted principal amount of the 2015 Notes relative to its exchange obligations, but retained the right to satisfy the exchange obligation in excess of the accreted principal amount in cash and/or common stock.

Although the Company has retained the right to satisfy the exchange obligation in excess of the accreted principal amount of the 2013 Notes and 2015 Notes in cash and/or common stock, Accounting Standards Codification (“ASC”) 260, “Earnings per Share,” requires an assumption that shares would be used to pay such exchange obligation, 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 and six months ended June 30, 2016 and 2015, 456,768 and 836,630 shares, respectively, related to the 2013 Notes were included in the computation for diluted earnings per share. For the three and six months ended June 30, 2016, no shares related to the 2015 Notes were included in the computation for diluted earnings per share as the exchange price exceeded the per share price of the Company’s common stock during these periods. For the three and six months ended June 30, 2015, no shares related to the 2015 Notes were included in the computation for diluted earnings per share as the 2015 Notes were not outstanding during these periods.

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

For the purposes of computing the diluted impact on earnings per share of the potential exchange of Series A Units for common shares upon redemption, 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 Series A 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 purposes of computing the diluted impact on earnings per share of the potential exchange of Series B Units for common shares upon redemption, where the Company has the option to redeem in cash or shares and where the Company has stated the intent and ability to settle the redemption in shares, the Company divided the total value of the Series B Units outstanding as of June 30, 2016 of \$41,901 by the closing price of the Company's common stock as of June 30, 2016 of \$92.54 per share. Assuming full exchange for common shares as of June 30, 2016, 452,788 shares would have been issued to the holders of the Series B Units.



## EXTRA SPACE STORAGE INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

Amounts in thousands, except store and share data, unless otherwise stated

For the purposes of computing the diluted impact on earnings per share of the potential exchange of Series C Units for common shares upon redemption, where the Company has the option to redeem in cash or shares and where the Company has stated the intent and ability to settle the redemption in shares, the Company divided the total value of the Series C Units outstanding as of June 30, 2016 of \$29,639 by the closing price of the Company's common stock as of June 30, 2016 of \$92.54 per share. Assuming full exchange for common shares as of June 30, 2016, 320,283 shares would have been issued to the holders of the Series C Units.

For the purposes of computing the diluted impact on earnings per share of the potential exchange of Series D Units for common shares upon redemption, where the Company has the option to redeem in cash or shares and where the Company has stated the intent and ability to settle the redemption in shares, the Company divided the total value of the Series D Units outstanding as of June 30, 2016 of \$68,747 by the closing price of the Company's common stock as of June 30, 2016 of \$92.54 per share. Assuming full exchange for common shares as of June 30, 2016, 742,890 shares would have been issued to the holders of the Series D Units.

The computation of earnings per common share was as follows for the periods presented:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2016	2015	2016	2015
Net income attributable to common stockholders	\$83,044	\$ 55,339	\$165,636	\$ 109,081
Earnings and dividends allocated to participating securities	(214 )	(140 )	(380 )	(259 )
Earnings for basic computations	82,830	55,199	165,256	108,822
Earnings and dividends allocated to participating securities	—	—	380	—
Income allocated to noncontrolling interest - Preferred Operating Partnership (Series A Units) and Operating Partnership	5,398	4,276	10,872	7,911
Fixed component of income allocated to noncontrolling interest - Preferred Operating Partnership (Series A Units)	(1,271 )	(1,271 )	(2,542 )	(2,545 )
Net income for diluted computations	\$86,957	\$ 58,204	\$173,966	\$ 114,188
Weighted average common shares outstanding:				
Average number of common shares outstanding - basic	124,914,467	116,861,678	124,678,293	116,491,710
Series A Units	875,480	875,480	875,480	875,480
OP Units	5,517,607	5,642,737	5,569,537	5,007,835
Unvested restricted stock awards included for treasury stock method	—	—	309,987	—
Shares related to exchangeable senior notes and dilutive stock options	718,361	1,095,995	719,222	1,102,216
Average number of common shares outstanding - diluted	132,025,915	124,475,890	132,152,519	123,477,241
Earnings per common share				
Basic	\$0.66	\$ 0.47	\$1.33	\$ 0.93
Diluted	\$0.66	\$ 0.47	\$1.32	\$ 0.92

## EXTRA SPACE STORAGE INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

Amounts in thousands, except store and share data, unless otherwise stated

## 5. STORE ACQUISITIONS

The following table shows the Company's acquisitions of operating stores for the six months ended June 30, 2016, and does not include purchases of raw land or improvements made to existing assets:

Property Location	Number of Stores	Date of Acquisition	Consideration Paid				Net Liabilities/(Assets) Assumed	Value of OP Units Issued	Number of OP Units Issued	Fair Value Real estate assets
			Total	Cash Paid	Loan Assumed					
Massachusetts	1	6/30/2016	\$13,807	\$13,751	\$—	\$ 56	\$—	—	\$13,807	
Georgia	1	6/30/2016	7,993	6,789	—	4	1,200	13,764	7,993	
Illinois	4	6/10/2016	55,851	—	—	814	55,037	2,201,467	55,851	
Texas	4	6/2/2016	37,478	37,246	—	232	—	—	37,478	
South Carolina	1	5/10/2016	8,249	8,230	—	19	—	—	8,249	
Washington, DC	1	5/5/2016	32,968	23,163	9,723	82	—	—	32,968	
Indiana	5	4/22/2016	26,983	26,849	—	134	—	—	26,983	
Colorado	1	4/19/2016	7,904	7,869	—	35	—	—	7,904	
Arizona	1	4/18/2016	8,154	8,029	—	125	—	—	8,154	
Texas	1	4/15/2016	10,978	10,922	—	56	—	—	10,978	
Arizona	1	4/5/2016	5,000	4,999	—	1	—	—	5,000	
Hawaii	1	4/5/2016	28,992	28,935	—	57	—	—	28,992	
New Mexico	1	3/29/2016	10,958	10,928	—	30	—	—	10,958	
New Mexico	1	3/29/2016	17,940	17,905	—	35	—	—	17,940	
Georgia	3	3/29/2016	25,087	25,069	—	18	—	—	25,087	
Texas	1	3/21/2016	9,994	9,969	—	25	—	—	9,994	
Illinois	1	2/25/2016	16,721	16,738	—	(17)	) —	—	16,721	
Massachusetts	1	2/16/2016	16,169	16,174	—	(5)	) —	—	16,169	
Florida, Maryland, Nevada, New York, Tennessee (1)	6	2/2/2016	53,898	53,940	—	(42)	) —	—	98,082	
Texas	3	1/14/2016	22,625	22,523	—	102	—	—	22,625	
Florida	1	1/12/2016	9,001	8,980	—	21	—	—	9,001	
Texas	3	1/7/2016	27,537	27,435	—	102	—	—	27,537	
New Mexico	2	1/7/2016	15,607	15,495	—	112	—	—	15,607	
2016 Totals	45		\$469,894	\$401,938	\$ 9,723	\$ 1,996	\$56,237	2,215,231	\$514,078	

(1) On February 2, 2016, the Company acquired six stores from its VRS Self Storage LLC joint venture ("VRS") in a step acquisition. The Company owns 45.04% of VRS, with the other 54.96% owned by affiliates of Prudential Real Estate ("Prudential"). VRS created a new subsidiary, Extra Space Properties 122 LLC ("ESP 122") and transferred six stores into ESP 122. VRS then distributed ESP 122 to the Company and Prudential on a pro rata basis. This distribution was accounted for as a spinoff, and was therefore recorded at the net carrying amount of the properties of \$17,261. Immediately after the distribution, the Company acquired Prudential's 54.96% interest in ESP 122 for \$53,940, resulting in 100% ownership of ESP 122 and the related six stores. Based on the purchase price of Prudential's share of ESP 122, the Company determined that the fair value of its investment in ESP 122

immediately prior to the acquisition of Prudential's share was \$44,184, and the Company recorded a gain of \$26,923 as a result of re-measuring to fair value its existing equity interest in ESP 122. This gain is included in equity in earnings of unconsolidated real estate ventures - gain on sale of real estate assets and purchase of joint venture partners' interests on the Company's condensed consolidated statements of operations.

EXTRA SPACE STORAGE INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

Amounts in thousands, except store and share data, unless otherwise stated

Store Dispositions

On April 20, 2016, the Company closed on the sale of seven operating stores located in Ohio and Indiana that had been classified as held for sale for \$17,555 in cash. The Company recognized a gain of \$11,265 related to this disposition.

On April 1, 2016, the Company disposed of a single store in Texas in exchange for 85,452 of our OP Units valued at \$7,689. The Operating Partnership has canceled the OP Units received in this disposition. The Company recognized a gain of \$93 related to this disposition.

Losses on Earnout from Prior Acquisition

In December 2014, the Company acquired a portfolio of five stores located in New Jersey and Virginia. As part of this acquisition, the Company agreed to make an additional cash payment to the sellers if the acquired stores exceeded a specified amount of net operating income for the years ending December 31, 2015 and 2016. At the acquisition date, the Company recorded an estimated liability related to this earnout provision. The operating income of these stores during the earnout period has been higher than expected, resulting in an increase in the estimate of the amount due to the sellers of \$1,544, which was recorded as a loss and included in loss earnout from prior acquisitions in the Company's condensed consolidated statements of operations for six months ended June 30, 2016.

6. INVESTMENTS IN UNCONSOLIDATED REAL ESTATE VENTURES

On May 20, 2016, the Company entered into a new joint venture, BH Storage Columbia LLC ("BH"). BH owns a single store located in South Carolina. The Company contributed a total of \$1,034 for a 20.0% interest in BH. The Company accounts for its investment in BH under the equity method of accounting.

On April 25, 2016, the Company and Prudential entered into the "Second Amendment to Amended and Restated Operating Agreement of ESS PRISA LLC" and the "First Amendment to Amended and Restated Operating Agreement of ESS PRISA II LLC" (the "Amendments"). The Amendments are deemed effective as of April 1, 2016. Under the Amendments, the Company gave up any future rights to receive distributions from these joint ventures at the higher "excess profit participation" percentage of 17.0% in exchange for a higher equity ownership percentage. The Company's equity ownership in ESS PRISA LLC increased from 2.0% to 4.0%, and the Company's equity ownership in ESS PRISA II LLC increased from 2.0% to 4.4%. The Company continues to account for its investment in these joint ventures under the equity method of accounting.

On April 8, 2016, the Company entered into a new joint venture, PR EXR Self Storage, LLC ("PREXR"). PREXR owns a single store located in New York. The Company contributed a total of \$12,114 for a 25.0% interest in PREXR. The Company accounts for its investment in PREXR under the equity method of accounting.

On March 31, 2016, the Company entered into a new joint venture, ESS-H Baychester Investments LLC ("Baychester"). Baychester owns a single store in New York. The Company contributed \$4,794 for a 44.4% interest in Baychester. The Company accounts for its investment in Baychester under the equity method of accounting.

7. VARIABLE INTERESTS

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 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.

## EXTRA SPACE STORAGE INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

Amounts in thousands, except store and share data, unless otherwise stated

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 equal to the notes payable that the Trusts owe to third parties for their investments in the Trusts' preferred securities.

Following is a tabular comparison of the assets and 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 June 30, 2016:

	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	—
Unamortized debt issuance costs (2,332 )				
	\$ 117,258	\$ 3,590	\$ 116,000	\$ —

The Company had no consolidated VIEs during the six months ended June 30, 2016.

## 8. DERIVATIVES

The Company is exposed to certain risks arising from both its business operations and economic conditions. The Company principally manages its exposures to a wide variety of business and operational risks through management of its core business activities. The Company manages economic risks, including interest rate, liquidity and credit risk, primarily by managing the amount, sources and duration of its debt funding and by using derivative financial instruments. Specifically, the Company enters into derivative financial instruments to manage exposure that arises from business activities that result in the receipt or payment of future known and uncertain cash amounts, the value of which are determined by interest rates. The Company's derivative financial instruments are used to manage differences in the amount, timing and duration of the Company's known or expected cash receipts and its known or expected cash payments principally related to the Company's investments and borrowings.

### Cash Flow Hedges of Interest Rate Risk

The Company's objectives in using interest rate derivatives are to add stability to interest expense and to manage its exposure to interest rate movements. To accomplish these objectives, the Company primarily uses interest rate swaps as part of its interest rate risk management strategy. Interest rate swaps designated as cash flow hedges involve the receipt of variable amounts from a counterparty in exchange for the Company making fixed-rate payments over the life of the agreements without exchange of the underlying notional amount.

The effective portion of changes in the fair value of derivatives designated and that qualify as cash flow hedges is recorded in accumulated other comprehensive income ("OCI") and is subsequently reclassified into earnings in the period that the hedged forecasted transaction affects earnings. A portion of these changes is excluded from accumulated other comprehensive income as it is allocated to noncontrolling interests. During the three and six months ended June 30, 2016 and 2015, such derivatives were used to hedge the variable cash flows associated with existing variable-rate debt. During the remainder of 2016, the Company estimates that an additional \$19,368 will be reclassified as an increase to interest expense.

The Company held 30 derivative financial instruments which had a total combined notional amount of \$2,058,385 as of June 30, 2016.

EXTRA SPACE STORAGE INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

Amounts in thousands, except store and share data, unless otherwise stated

Fair Values of Derivative Instruments

The table below presents the fair value of the Company's derivative financial instruments as well as their classification on the condensed consolidated balance sheets:

	Asset (Liability)	
	Derivatives	
	June 30, 2016	December 31, 2015
Derivatives designated as hedging instruments:	Fair Value	
Other assets	\$36	\$4,996
Other liabilities	\$(53,103)	\$(6,991)

Effect of Derivative Instruments

The tables below present the effect of the Company's derivative financial instruments on the condensed consolidated statements of operations for the periods presented. No tax effect has been presented as the derivative instruments are held by the Company:

Type	Gain (loss) recognized in OCI For the Three Months Ended June 30,		Location of amounts reclassified from OCI into income	Gain (loss) reclassified from OCI For the Three Months Ended June 30,	
	2016	2015		2016	2015
Swap Agreements	\$(23,655)	\$3,417	Interest expense	\$(4,861)	\$(2,636)

Type	Gain (loss) recognized in OCI For the Six Months Ended June 30,		Location of amounts reclassified from OCI into income	Gain (loss) reclassified from OCI For the Six Months Ended June 30,	
	2016	2015		2016	2015
Swap Agreements	\$(58,616)	\$(5,458)	Interest expense	\$(9,314)	\$(4,933)

Credit-risk-related Contingent Features

The Company has agreements with some of its derivative counterparties that contain provisions pursuant to which the Company could be declared in default of its derivative obligations if the Company defaults on any of its indebtedness, including default where repayment of the indebtedness has not been accelerated by the lender.

The Company also has an agreement with some of its derivative counterparties that incorporates the loan covenant provisions of the Company's indebtedness with a lender affiliate of the derivative counterparty. Failure to comply with the loan covenant provisions would result in the Company being in default on any derivative instrument obligations covered by the agreement.

As of June 30, 2016, the fair value of derivatives in a net liability position, which includes accrued interest but excludes any adjustment for nonperformance risk, related to these agreements was \$53,103. As of June 30, 2016, the Company had not posted any collateral related to these agreements. If the Company had breached any of these provisions as of June 30, 2016, it could have been required to settle its obligations under the agreements at their



termination value of \$56,465, including accrued interest.

#### 9. EXCHANGEABLE SENIOR NOTES

In September 2015, the Operating Partnership issued \$575,000 of its 3.125% Exchangeable Senior Notes due 2035. Costs incurred to issue the 2015 Notes were approximately \$11,992, consisting primarily of a 2% underwriting fee. These costs are being amortized as an adjustment to interest expense over five years, which represents the estimated term based on the first available redemption date, and are included in exchangeable senior notes, net, in the condensed consolidated balance sheets. The 2015 Notes are general unsecured senior obligations of the Operating Partnership and are fully guaranteed by the Company. Interest is payable on April 1 and October 1 of each year beginning April 1, 2016, until the maturity date of October 1, 2035. The Notes bear interest at 3.125% per annum and contain an exchange settlement feature, which provides that the 2015 Notes may, under certain circumstances, be exchangeable for cash (for the principal amount of the 2015 Notes) and, with respect to any excess exchange value, for cash, shares of the Company's common stock, or a combination of cash and

EXTRA SPACE STORAGE INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

Amounts in thousands, except store and share data, unless otherwise stated

shares of the Company's common stock, at the Company's option. The exchange rate of the 2015 Notes as of June 30, 2016 was approximately 10.51 shares of the Company's common stock per \$1,000 principal amount of the 2015 Notes.

The Operating Partnership may redeem the 2015 Notes at any time to preserve the Company's status as a REIT. In addition, on or after October 5, 2020, the Operating Partnership may redeem the 2015 Notes for cash, in whole or in part, at 100% of the principal amount plus accrued and unpaid interest, upon at least 30 days but not more than 60 days prior written notice to the holders of the 2015 Notes. The holders of the 2015 Notes have the right to require the Operating Partnership to repurchase the 2015 Notes for cash, in whole or in part, on October 1 of the years 2020, 2025 and 2030 (unless the Operating Partnership has called the 2015 Notes for redemption), and upon the occurrence of certain designated events, in each case for a repurchase price equal to 100% of the principal amount of the 2015 Notes plus accrued and unpaid interest. Certain events are considered "Events of Default," as defined in the indenture governing the 2015 Notes, which may result in the accelerated maturity of the 2015 Notes.

On June 21, 2013, the Operating Partnership issued \$250,000 of its 2.375% Exchangeable Senior Notes due 2033 at a 1.5% discount, or \$3,750. Costs incurred to issue the 2013 Notes were approximately \$1,672. These costs are being amortized as an adjustment to interest expense over five years, which represents the estimated term based on the first available redemption date, and are included in exchangeable senior notes, net, in the condensed consolidated balance sheets. The 2013 Notes are general unsecured senior obligations of the Operating Partnership and are fully guaranteed by the Company. Interest is payable on January 1 and July 1 of each year beginning January 1, 2014, until the maturity date of July 1, 2033. The 2013 Notes bear interest at 2.375% per annum and contain an exchange settlement feature, which provides that the 2013 Notes may, under certain circumstances, be exchangeable for cash (for the principal amount of the 2013 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 Company's option. The exchange rate of the 2013 Notes as of June 30, 2016 was approximately 18.30 shares of the Company's common stock per \$1,000 principal amount of the 2013 Notes.

The Operating Partnership may redeem the 2013 Notes at any time to preserve the Company's status as a REIT. In addition, on or after July 5, 2018, the Operating Partnership may redeem the 2013 Notes for cash, in whole or in part, at 100% of the principal amount plus accrued and unpaid interest, upon at least 30 days but not more than 60 days prior written notice to the holders of the 2013 Notes. The holders of the 2013 Notes have the right to require the Operating Partnership to repurchase the 2013 Notes for cash, in whole or in part, on July 1 of the years 2018, 2023 and 2028, and upon the occurrence of certain designated events, in each case for a repurchase price equal to 100% of the principal amount of the 2013 Notes plus accrued and unpaid interest. Certain events are considered "Events of Default," as defined in the indenture governing the 2013 Notes, which may result in the accelerated maturity of the 2013 Notes.

Additionally, the 2013 Notes and the 2015 Notes can be exchanged during any calendar quarter, if the last reported sale price of the common stock of the Company is greater than or equal to 130% of the exchange price for at least 20 trading days during a period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter. The price of the Company's common stock exceeded 130% of the exchange price for the required time period for the 2013 Notes during the quarter ended June 30, 2016. Therefore, holders of the 2013 Notes may elect to exchange such notes during the quarter ending September 30, 2016. The price of the Company's common stock did not exceed 130% of the exchange price for the required time period for the 2015 Notes during the quarter ended June 30, 2016.

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 2013 Notes and 2015 Notes separately. The equity components are included in paid-in capital in stockholders' equity in the condensed consolidated balance sheets, and the value of the equity components are treated as original issue discount for purposes of accounting for the debt components. The discounts are being amortized as interest expense over the remaining period of the debt through its first redemption date: July 1, 2018 for the 2013 Notes, and October 1, 2020 for the 2015 Notes. The effective interest rate on the liability components of both the 2013 Notes and the 2015 Notes is 4.0%, which approximates the market rate of interest of similar debt without exchange features (i.e. nonconvertible debt) at the time of issuance.

## EXTRA SPACE STORAGE INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

Amounts in thousands, except store and share data, unless otherwise stated

Information about the Company's 2013 Notes and 2015 Notes, including the total carrying amounts of the equity components, the principal amounts of the liability components, the unamortized discounts and the net carrying amounts was as follows for the periods indicated:

	June 30, 2016	December 31, 2015
Carrying amount of equity component - 2013 Notes	\$—	\$—
Carrying amount of equity component - 2015 Notes	22,597	22,597
Carrying amount of equity components	\$22,597	\$22,597
Principal amount of liability component 2013 Notes	\$63,172	\$85,364
Principal amount of liability component 2015 Notes	575,000	575,000
Unamortized discount - equity component - 2013 Notes	(1,568 )	(2,605 )
Unamortized discount - equity component - 2015 Notes	(19,481 )	(21,565 )
Unamortized cash discount - 2013 Notes	(374 )	(633 )
Unamortized debt issuance costs	(10,327 )	(11,698 )
Net carrying amount of liability components	\$606,422	\$623,863

The amount of interest cost recognized relating to the contractual interest rates and the amortization of the discounts on the liability components of the Notes were as follows for the periods indicated:

	For the Three Months Ended June 30, 2016		For the Six Months Ended June 30, 2015	
Contractual interest	\$4,867	\$1,484	\$9,749	\$2,968
Amortization of discount	1,240	696	2,473	1,393
Total interest expense recognized	\$6,107	\$2,180	\$12,222	\$4,361

## Repurchases of 2013 Notes

During April 2016, the Company repurchased a total principal amount of \$2,553 of the 2013 Notes. The Company paid cash for the principal amount and issued a total of 18,031 shares of common stock valued at \$1,686 for the exchange value in excess of the principal amount. During February 2016, the Company repurchased a total principal amount of \$19,639 of the 2013 Notes. The Company paid cash for the principal amount, and issued a total of 130,909 shares of common stock valued at \$11,380 for the exchange value in excess of the principal amount.

The Company allocated the value of the consideration paid to repurchase the 2013 Notes (1) to the extinguishment of the liability component and (2) to the reacquisition of the equity component. The amount allocated to the extinguishment of the liability component is equal to the fair value of that component immediately prior to extinguishment. The difference between the consideration attributed to the extinguishment of the liability component and the sum of (a) the net carrying amount of the repurchased liability component, and (b) the related unamortized debt issuance costs, is recognized as a gain on debt extinguishment. The remaining settlement consideration is allocated to the reacquisition of the equity component of the repurchased 2013 Notes and recognized as a reduction of stockholders' equity.



## EXTRA SPACE STORAGE INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

Amounts in thousands, except store and share data, unless otherwise stated

Information about the repurchases is as follows:

	February 2016	April 2016
Principal amount repurchased	\$19,639	\$2,553
Amount allocated to:		
Extinguishment of liability component	\$18,887	\$2,474
Reacquisition of equity component	12,132	1,766
Total consideration paid for repurchase	\$31,019	\$4,240
Exchangeable senior notes repurchased	\$19,639	\$2,553
Extinguishment of liability component	(18,887 )	(2,474 )
Discount on exchangeable senior notes	(716 )	(72 )
Related debt issuance costs	(36 )	(7 )
Gain/(loss) on repurchase	\$—	\$—

## 10. STOCKHOLDERS' EQUITY

On August 28, 2015, the Company filed a \$400,000 "at the market" equity program with the Securities and Exchange Commission, and entered into separate equity distribution agreements with five sales agents. On May 6, 2016, the Company filed its current \$400,000 "at the market" equity program with the Securities and Exchange Commission using a new shelf registration statement on Form S-3, and entered into separate equity distribution agreements with six sales agents. Under the terms of the current equity distribution agreements, the Company may from time to time offer and sell shares of common stock, up to the aggregate offering price of \$400,000, through its sales agents. The current equity distribution agreements, dated May 6, 2016, replaced and superseded the previous equity distribution agreements, dated August 28, 2015.

During the six months ended June 30, 2016, the Company sold 831,300 shares of common stock under the previous "at the market" equity program at an average sales price of \$89.66 per share, resulting in net proceeds of \$73,360.

On June 22, 2015, the Company issued and sold 6,325,000 shares of its common stock in a public offering at a price of \$68.15 per share. The Company received gross proceeds of \$431,049. The underwriting discount and transaction costs were \$14,438, resulting in net proceeds of \$416,611.

## 11. NONCONTROLLING INTEREST REPRESENTED BY PREFERRED OPERATING PARTNERSHIP UNITS

## Classification of Noncontrolling Interests

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 Operating Partnership's preferred units and classifies the noncontrolling interest represented by such preferred 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 interest 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 and (2) the redemption value as of the end of the period in which the determination is made.

EXTRA SPACE STORAGE INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

Amounts in thousands, except store and share data, unless otherwise stated

Series A Participating Redeemable Preferred 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 stores in exchange for 989,980 Series A Units of the Operating Partnership. The stores are located in California and Hawaii.

The partnership agreement of the Operating Partnership (as amended, the “Partnership Agreement”) provides for the designation and issuance of the Series A Units. The Series A Units will have priority over all other partnership interests of the Operating Partnership with respect to distributions and liquidation.

Under the Partnership Agreement, Series A 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 OP Units. The Series A Units are redeemable at the option of the holder, which redemption obligation may be satisfied, at the Company’s option, in cash or shares of its common stock.

On June 25, 2007, the Operating Partnership loaned the holders of the Series A Units \$100,000. The note receivable bears interest at 4.85%. During 2013, a loan amendment was signed extending the maturity date to September 1, 2020. The loan is secured by the borrower’s Series A Units. The holders of the Series A Units could redeem up to 114,500 Series A Units prior to the maturity date of the loan. If any redemption in excess of 114,500 Series A Units occurs prior to the maturity date, the holder of the Series A Units is required to repay the loan as of the date of that redemption. On October 3, 2014, the holders of the Series A Units redeemed 114,500 Series A Units for \$4,794 in cash and 280,331 shares of common stock. No additional redemption of Series A Units can be made without repayment of the loan. The Series A 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 Series A Units.

Series B Redeemable Preferred Units

On April 3, 2014, the Operating Partnership completed the purchase of a store located in Georgia. This store was acquired in exchange for \$15,158 of cash and 333,360 Series B Units valued at \$8,334.

On August 29, 2013, the Operating Partnership completed the purchase of 19 out of 20 stores affiliated with All Aboard Mini Storage, all of which are located in California. On September 26, 2013, the Operating Partnership completed the purchase of the remaining store. These stores were acquired in exchange for \$100,876 of cash (including \$98,960 of debt assumed and immediately defeased at closing), 1,342,727 Series B Units valued at \$33,568, and 1,448,108 OP Units valued at \$62,341.

The Partnership Agreement provides for the designation and issuance of the Series B Units. The Series B Units rank junior to the Series A Units, on parity with the Series C Units and Series D Units, and senior to all other partnership interests of the Operating Partnership with respect to distributions and liquidation.

The outstanding Series B Units have a liquidation value of \$25.00 per unit for a fixed liquidation value of \$41,902. Holders of the Series B Units receive distributions at an annual rate of 6.0%. These distributions are cumulative. The Series B Units became redeemable at the option of the holder on the first anniversary of the date of issuance, which redemption obligation may be satisfied at the Company’s option in cash or shares of its common stock.

Series C Convertible Redeemable Preferred Units

On November 19, 2013, the Company entered into Contribution Agreements with various entities affiliated with Grupe Properties Co. Inc. (“Grupe”), under which the Company agreed to acquire twelve stores, all of which are located in California. The Company completed the purchase of these stores between December 2013 and May 2014. The



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

Company previously held 35% interests in five of these stores and a 40% interest in one store through six separate joint ventures with Grupe. These stores were acquired in exchange for a total of approximately \$45,722 of cash, the assumption of \$37,532 in existing debt, and the issuance of 704,016 Series C Units valued at \$30,960.

The Partnership Agreement provides for the designation and issuance of the Series C Units. The Series C Units rank junior to the Series A Units, on parity with the Series B Units and Series D Units, and senior to all other partnership interests of the Operating Partnership with respect to distributions and liquidation.

The outstanding Series C Units have a liquidation value of \$42.10 per unit for a fixed liquidation value of \$29,639. From issuance to the fifth anniversary of issuance, each Series C Unit holder will receive quarterly distributions equal to the quarterly distribution per OP Unit plus \$0.18. Beginning on the fifth anniversary of issuance, each Series C Unit holder will receive a

EXTRA SPACE STORAGE INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

Amounts in thousands, except store and share data, unless otherwise stated

fixed quarterly distribution equal to the aggregate quarterly distribution payable in respect of such Series C Unit during the four quarters immediately preceding the fifth anniversary of issuance, divided by four. These distributions are cumulative. The Series C Units became redeemable at the option of the holder one year from the date of issuance, which redemption obligation may be satisfied at the Company's option in cash or shares of its common stock. The Series C Units also became convertible into OP Units at the option of the holder one year from the date of issuance, at a rate of 0.9145 OP Units per Series C Unit converted. This conversion option expires upon the fifth anniversary of the date of issuance.

In December 2014, the Operating Partnership loaned certain holders of the Series C Units \$20,230. The notes receivable, which are collateralized by the Series C Units, bear interest at 5.0% per annum and mature on December 15, 2024. The Series C Units are shown on the balance sheet net of the \$20,230 loan because the borrower under the loan receivable is also the holder of the Series C units.

Series D Redeemable Preferred Units

On May 21, 2016, the Operating Partnership completed the acquisition of four stores located in Illinois. These stores were acquired in exchange for 2,201,467 Series D-3 Preferred Units ("D-3 Units") valued at \$55,037.

In December 2014, the Operating Partnership completed the acquisition of a store located in Florida. This store was acquired in exchange for \$5,621 in cash and 548,390 Series D-1 Preferred Units ("D-1 Units," and together with the D-3 Units, "Series D Units") valued at \$13,710.

The Partnership Agreement provides for the designation and issuance of the Series D Units. The Series D Units rank junior to the Series A Units, on parity with the Series B Units and Series C Units, and senior to all other partnership interests of the Operating Partnership with respect to distributions and liquidation.

The Series D Units have a liquidation value of \$25.00 per unit, for a fixed liquidation value of \$68,747. Holders of the Series D Units receive distributions at an annual rate between 4.0% to 5.0%. These distributions are cumulative. The Series D Units become redeemable at the option of the holder on the first anniversary of the date of issuance, which redemption obligation may be satisfied at the Company's option in cash or shares of its common stock. In addition the Series D-3 Units are exchangeable for common OP Units until the 10th anniversary of the date of issuance. The Series D-1 Units are not exchangeable for common OP Units.

## 12. NONCONTROLLING INTEREST IN OPERATING PARTNERSHIP

The Company's interest in its stores 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. ESS Holding Business Trust II, also a wholly-owned subsidiary of the Company, is a limited partner of the Operating Partnership. Between its general partner and limited partner interests, the Company held a 91.6% ownership interest in the Operating Partnership as of June 30, 2016. The remaining ownership interests in the Operating Partnership (including Preferred Operating Partnership units) of 8.4% are held by certain former owners of assets acquired by the Operating Partnership.

The noncontrolling interest in the Operating Partnership represents 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 stores to the Operating Partnership received limited partnership interests in the form of OP Units. Limited partners who received OP Units in the formation transactions or in exchange for contributions for interests in stores have the right to require the Operating Partnership to redeem part or all of their OP Units for cash

based upon the fair market value of an equivalent number of shares of the Company's common stock (based on the ten-day average trading price) at the time of the redemption. Alternatively, the Company may, in its sole discretion, 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 June 30, 2016 was \$88.88 and there were 5,528,614 OP Units outstanding. Assuming that all of the OP Unit holders exercised their right to redeem all of their OP Units on June 30, 2016 and the Company elected to pay the OP Unit holders cash, the Company would have paid \$491,383 in cash consideration to redeem the 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

EXTRA SPACE STORAGE INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

Amounts in thousands, except store and share data, unless otherwise stated

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 OP Units and classifies the noncontrolling interest represented by the 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 and (2) the redemption value as of the end of the period in which the determination is made.

### 13. OTHER NONCONTROLLING INTERESTS

Other noncontrolling interests represent the ownership interest of third parties in two consolidated joint ventures as of June 30, 2016. One of these consolidated joint ventures owns an operating store in California, and the other owns an operating store in Texas. The voting interests of the third-party owners range from 17.5% to 20.0%. Other noncontrolling interests are included in the stockholders' equity section of the Company's condensed consolidated balance sheets. The income or losses attributable to this third-party owner based on its ownership percentage are reflected in net income allocated to Operating Partnership and other noncontrolling interests in the condensed consolidated statements of operations.

On June 11, 2015, the Company purchased its joint venture partner's remaining 1% interest in an existing joint venture for \$1,267. The joint venture owned 19 properties in California, Florida, Nevada, Ohio, Pennsylvania, Tennessee, Texas and Virginia, and as a result of this purchase, these properties became wholly-owned by the Company. Prior to this acquisition, the partner's interest was reported in other noncontrolling interests. Since the Company retained its controlling interest in the subsidiary, this transaction was accounted for as an equity transaction. The carrying amount of the noncontrolling interest was reduced to zero to reflect the purchase, and the difference between the price paid by the Company and the carrying value of the noncontrolling interest was recorded as an adjustment to equity attributable to the Company.

### 14. EQUITY IN EARNINGS OF UNCONSOLIDATED REAL ESTATE VENTURES—GAIN ON SALE OF REAL ESTATE AND PURCHASE OF JOINT VENTURE PARTNERS' INTERESTS

On February 2, 2016, the Company acquired six operating stores from VRS in a step acquisition. The Company recognized a non-cash gain of \$26,923 related to this transaction as a result of revaluing its existing equity interest upon the purchase of the remaining interest. See the Store Acquisitions footnote for more information.

In March 2015, ESS PRISA II LLC ("PRISA II"), a joint venture in which the Company held a 2.0% interest, sold one store located in New York for \$90,000. As a result of the sale, PRISA II recognized a gain of \$60,496 and the Company recorded its 2.0% portion of the gain, or \$1,228.

In March 2015, the Company acquired its joint venture partner's 82.4% interest in Sacramento One, an existing joint venture which owned one store located in California, for \$1,700. In addition, the Company held mortgage notes receivable from Sacramento One totaling \$11,009, which were written off as part of the total consideration. Prior to the acquisition, the remaining 17.6% interest was owned by the Company, which accounted for its investment in Sacramento One using the equity method. The Company recorded a non-cash gain of \$1,629 related to this transaction, which represents the increase in fair value of the Company's interest in the joint venture from its formation

to the acquisition date.

25

---

## EXTRA SPACE STORAGE INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

Amounts in thousands, except store and share data, unless otherwise stated

## 15. SEGMENT INFORMATION

The Company operates in three distinct segments: (1) rental operations; (2) tenant reinsurance; and (3) property management, acquisition and development. Management fees collected for wholly-owned stores are eliminated in consolidation. Financial information for the Company's business segments is presented below:

	June 30, 2016	December 31, 2015		
Balance Sheet				
Investment in unconsolidated real estate ventures				
Rental operations	\$99,576	\$ 103,007		
Total assets				
Rental operations	\$6,130,870	\$5,674,030		
Tenant reinsurance	38,749	37,696		
Property management, acquisition and development	289,379	359,681		
	\$6,458,998	\$6,071,407		
			For the Three Months Ended June 30,	For the Six Months Ended June 30,
			2016	2015
			2016	2015
Statement of Operations				
Total revenues				
Rental operations			\$211,791	\$161,024
Tenant reinsurance			21,654	17,340
Property management, acquisition and development			10,828	7,496
			244,273	185,860
Operating expenses, including depreciation and amortization				
Rental operations			104,161	77,326
Tenant reinsurance			3,941	3,283
Property management, acquisition and development			25,869	23,644
			133,971	104,253
Income (loss) from operations				
Rental operations			107,630	83,698
Tenant reinsurance			17,713	14,057
Property management, acquisition and development			(15,041 )	(16,148 )
			110,302	81,607
Gain on real estate transactions and earnout from prior acquisition				
Property management, acquisition and development			11,358	400
Interest expense				
Rental operations			(31,941 )	(22,703 )
Property management, acquisition and development			(861 )	(108 )
			(32,802 )	(22,811 )
Non-cash interest expense related to the amortization of discount on equity component of exchangeable senior notes				
Property management, acquisition and development			(1,240 )	(696 )
Interest income				
Tenant reinsurance			3	4
			6	8

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

Property management, acquisition and development	1,622	424	3,333	1,276
	1,625	428	3,339	1,284
Interest income on note receivable from Preferred Operating Partnership unit holder				
Property management, acquisition and development	1,212	1,212	2,425	2,425
Equity in earnings of unconsolidated real estate ventures				
Rental operations	3,358	3,001	6,188	5,651
Equity in earnings of unconsolidated real estate ventures - gain on sale of real estate assets and purchase of partners' interests				
Property management, acquisition and development	—	—	26,923	2,857
Income tax (expense) benefit				
Rental operations	(445	) (325	) (1,290	) (1,079
Tenant reinsurance	(3,185	) (2,429	) (5,848	) (4,303
Property management, acquisition and development	(143	) 569	600	949
	(3,773	) (2,185	) (6,538	) (4,433
Net income (loss)				
Rental operations	78,602	63,671	147,812	117,795
Tenant reinsurance	14,531	11,632	28,115	23,344
Property management, acquisition and development	(3,093	) (14,347	) 3,520	(21,547
	\$90,040	\$60,956	\$179,447	\$119,592

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2016	2015	2016	2015
Depreciation and amortization expense				
Rental operations	\$41,731	\$29,117	\$82,317	\$57,382
Property management, acquisition and development	2,219	2,435	4,530	4,598
	\$43,950	\$31,552	\$86,847	\$61,980
Statement of Cash Flows				
Acquisition of real estate assets				
Property management, acquisition and development			\$(435,298)	\$(240,892)
Development and redevelopment of real estate assets				
Property management, acquisition and development			\$(14,400)	\$(9,926)

## 16. COMMITMENTS AND CONTINGENCIES

As of June 30, 2016, the Company is involved in various legal proceedings and is subject to various claims and complaints arising in the ordinary course of business. Because litigation is inherently unpredictable, the outcome of these matters cannot presently be determined with any degree of certainty. In accordance with applicable accounting guidance, management establishes an accrued liability for litigation when those matters present loss contingencies that are both probable and reasonably estimable. In such cases, there may be an exposure to loss in excess of any amounts accrued. The estimated loss, if any, is based upon currently available information and is subject to significant judgment, a variety of assumptions, and known and unknown uncertainties. Therefore, any estimate(s) of loss disclosed below represents what management believes to be an estimate of loss only for certain matters meeting these criteria and does not represent the Company's maximum loss exposure. The Company could in the future incur judgments or enter into settlements of claims that could have a material adverse effect on its results of operations in any particular period, notwithstanding the fact that the Company is currently vigorously defending any legal proceedings against it.

The Company currently has a legal proceeding pending against it that includes causes of action alleging wrongful foreclosure, violations of various state specific self-storage statutes, and violations of various consumer fraud acts. As a result of this litigation matter, the Company recorded a liability of \$4,000 during the six months ended June 30, 2016, which is included in other liabilities on the condensed consolidated balance sheet.

As of June 30, 2016, the Company was under contract to acquire four operating stores and twelve stores to be acquired upon the completion of construction, for a total purchase price of \$190,748. Of these stores, seven are scheduled to close in 2016. The remaining stores will close upon completion of construction, expected to occur on various dates in 2017 and 2018. Additionally, the Company is under contract to acquire 21 stores with joint venture partners, for a total purchase price of \$409,947. Ten of these stores are scheduled to close in 2016 while the remaining eleven stores are expected to close in 2017 and 2018.

Although there can be no assurance, the Company is not aware of any material environmental liability, for which it believes it will be ultimately responsible, that could have a material adverse effect on its financial condition or results of operations. However, changes in applicable environmental laws and regulations, the uses and conditions of properties in the vicinity of the Company's properties, the activities of its tenants and other environmental conditions of which the Company is unaware with respect to its properties could result in future material environmental liabilities.



EXTRA SPACE STORAGE INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

Amounts in thousands, except store and share data, unless otherwise stated

17. SUBSEQUENT EVENTS

Subsequent to June 30, 2016, the Company purchased one store located in Hawaii for a total purchase price of \$31,000.

Subsequent to June 30, 2016, the Company sold 550,000 shares of its common stock under its "at the market" equity program. The average price of the shares sold was \$91.81, resulting in net proceeds of \$50,118.

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

Amounts in thousands, except store and share data

CAUTIONARY LANGUAGE

The following discussion and analysis should be read in conjunction with our unaudited "Condensed Consolidated Financial Statements" and the "Notes to Condensed Consolidated Financial Statements (unaudited)" 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, 2015. 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."

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, 2015 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 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

We are a fully integrated, self-administered and self-managed REIT, formed to continue the business commenced in 1977 by Extra Space Storage LLC and its subsidiaries to own, operate, manage, acquire, develop and redevelop professionally managed self-storage stores.

We derive substantially all of our revenues from rents received from tenants under leases at each of our wholly-owned stores; from management fees on the stores we manage for joint venture partners and unaffiliated third parties; and from our tenant reinsurance program. Our management fee is equal to approximately 6% of cash collected from the managed stores. We also receive an asset management fee of 0.5% of the total asset value from one of our joint ventures.

We operate in competitive markets, often where consumers have multiple stores from which to choose. Competition has impacted, and will continue to impact, our store 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 that 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 our stores 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 advanced technology system's ability to provide real-time, interactive rental rate and discount management. Our size allows us greater ability than the majority of our competitors to implement more effective online marketing programs, which we believe will attract more customers to our stores at a lower net cost.

Acquire self storage stores. Our acquisitions team continues to pursue the acquisition of multi-store portfolios and single stores 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.

Expand our management business. Our management business enables us to generate increased revenues through management fees and to expand our geographic footprint. We believe 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 whose stores would enhance our portfolio in the event an opportunity arises to acquire such stores.

## PROPERTIES

As of June 30, 2016, we owned, had ownership interests in, or managed 1,412 stores in 37 states, Washington, D.C. and Puerto Rico. Of these 1,412 stores, we owned 783 stores, we held joint venture interests in 252 stores, and our taxable REIT subsidiary, Extra Space Management, Inc., operated an additional 377 stores that are owned by third parties. These operating stores contain approximately 106 million square feet of rentable space in approximately 945,000 units.

Our stores 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 markets contain above-average population growth and income demographics. The clustering of assets around these population centers enables us to reduce our operating costs through economies of scale. Our acquisitions and management business 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 store 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 store to be stabilized once it has achieved either an 80% average occupancy rate for a full year measured as of January 1, or has been open for three years.

As of June 30, 2016, approximately 864,000 tenants were leasing storage units at the 1,412 operating stores that we own and/or manage, primarily on a month-to-month basis, providing the flexibility to increase rental rates over time as market conditions permit. Existing tenants generally receive rate increases at least annually, for which no direct correlation has been drawn to our vacancy trends. Although leases are short-term in duration, the typical tenant tends to remain at our stores for an extended period of time. For stores that were stabilized as of June 30, 2016, the average length of stay was approximately 14.1 months for tenants that vacated during the preceding twelve month period.

The average annual rent per square foot for our existing customers at stabilized stores, net of discounts and bad debt, was \$15.33 for the three months ended June 30, 2016, compared to \$14.35 for the three months ended June 30, 2015. Average annual rent per square foot for new leases was \$16.61 for the three months ended June 30, 2016, compared to \$15.62 for the three months ended June 30, 2015. The average discounts, as a percentage of rental revenues, during these periods were 3.5% and 3.4%, respectively.

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

Our store 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” stores, a mix of drive-up and multi-floor buildings. We have a number of multi-floor buildings with elevator access only, and a number of stores featuring ground-floor access only.

The following table presents additional information regarding the occupancy of our stabilized stores by state as of June 30, 2016 and 2015. The information as of June 30, 2015 is on a pro forma basis as though all the stores owned and/or managed at June 30, 2016 were under our control as of June 30, 2015.

Stabilized Store Data Based on Location

Location	Number of Stores	Company	Pro forma	Company	Pro forma	Company	Pro forma		
		Number of Units as of June 30, 2016 (1)	Number of Units as of June 30, 2015	Net Rentable Square Feet as of June 30, 2016 (2)	Net Rentable Square Feet as of June 30, 2015	Square Foot Occupancy % June 30, 2016	Square Foot Occupancy % June 30, 2015		
<b>Wholly-Owned Stores</b>									
Alabama	8	4,600	4,576	558,126	559,786	91.8	%	90.7	%
Arizona	19	11,320	11,266	1,265,917	1,268,440	93.3	%	91.0	%
California	135	103,001	102,280	10,714,995	10,715,685	95.7	%	95.1	%
Colorado	13	6,619	6,543	821,381	823,714	95.4	%	96.3	%
Connecticut	5	3,157	3,135	299,002	299,034	93.8	%	97.0	%
Florida	76	54,099	53,430	5,774,025	5,743,449	94.1	%	92.9	%
Georgia	47	27,799	27,756	3,621,570	3,638,224	93.1	%	91.7	%
Hawaii	6	6,658	6,526	430,851	426,454	91.4	%	91.2	%
Illinois	25	17,044	17,169	1,874,592	1,929,200	92.6	%	91.8	%
Indiana	12	6,556	6,497	780,162	784,127	94.2	%	89.4	%
Kansas	1	529	533	49,985	49,991	97.1	%	88.3	%
Kentucky	9	5,041	4,998	671,036	670,936	91.7	%	88.0	%
Louisiana	2	1,406	1,408	149,930	149,990	95.2	%	93.9	%
Maryland	25	19,025	18,918	1,966,172	1,967,448	94.8	%	94.1	%
Massachusetts	36	22,474	22,312	2,242,253	2,249,287	94.4	%	95.6	%
Michigan	3	1,831	1,821	259,801	258,877	94.8	%	95.0	%
Mississippi	3	1,493	1,483	220,142	221,482	88.4	%	85.1	%
Missouri	6	3,250	3,247	387,761	387,401	92.3	%	93.5	%
Nevada	15	9,109	9,140	1,313,570	1,315,430	92.1	%	89.6	%
New Hampshire	2	1,032	1,016	126,233	125,748	94.5	%	95.6	%
New Jersey	56	43,600	43,455	4,242,030	4,234,796	93.6	%	93.3	%
New Mexico	7	3,968	3,929	486,623	487,213	93.4	%	91.9	%
New York	22	20,053	19,922	1,650,158	1,647,688	93.8	%	93.5	%
North Carolina	11	6,858	6,793	761,500	763,499	92.8	%	94.2	%
Ohio	16	9,224	9,117	1,214,371	1,211,379	93.7	%	94.4	%
Oregon	3	2,156	2,157	250,130	250,450	97.2	%	97.6	%
Pennsylvania	14	9,628	9,651	1,045,118	1,042,690	90.1	%	89.8	%
Rhode Island	2	1,269	1,235	131,521	131,566	94.2	%	96.2	%
South Carolina	20	11,210	11,187	1,508,924	1,518,876	90.8	%	89.2	%
Tennessee	19	11,081	11,013	1,525,746	1,537,407	93.1	%	92.0	%
Texas	82	53,357	53,234	6,896,386	6,893,566	91.4	%	90.4	%

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

Utah	8	4,228	4,234	523,231	522,858	95.7	%	94.5	%
------	---	-------	-------	---------	---------	------	---	------	---

29

---

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

Location	Number of Stores	Company	Pro forma	Company	Pro forma	Company	Pro forma		
		Number of Units as of June 30, 2016 (1)	Number of Units as of June 30, 2015	Net Rentable Square Feet as of June 30, 2016 (2)	Net Rentable Square Feet as of June 30, 2015	Square Foot Occupancy % June 30, 2016	Square Foot Occupancy % June 30, 2015		
Virginia	36	27,224	26,988	2,894,744	2,891,651	93.7	%	91.8	%
Washington	6	3,598	3,592	428,468	428,588	98.0	%	94.8	%
Washington, DC	1	1,217	1,214	99,714	99,439	93.4	%	94.2	%
Total Wholly-Owned Stabilized	751	514,714	511,775	57,186,168	57,246,369	93.6	%	92.8	%
Joint-Venture Stores									
Alabama	2	1,180	1,168	145,046	145,106	93.4	%	97.2	%
Arizona	7	4,339	4,273	491,788	492,553	93.5	%	91.1	%
California	66	47,791	47,345	4,827,571	4,829,938	96.0	%	95.5	%
Colorado	2	1,312	1,316	158,112	158,769	93.0	%	97.5	%
Connecticut	7	5,323	5,315	611,765	611,045	95.0	%	95.1	%
Delaware	1	595	597	71,910	71,610	83.5	%	86.2	%
Florida	15	12,702	12,572	1,261,437	1,262,487	94.4	%	92.9	%
Georgia	2	1,098	1,080	150,744	152,554	91.8	%	91.8	%
Illinois	5	3,493	3,484	366,760	365,465	93.4	%	94.3	%
Indiana	5	2,269	2,228	288,685	288,990	94.4	%	93.8	%
Kansas	2	846	843	109,405	109,355	92.9	%	94.4	%
Kentucky	4	2,206	2,279	240,289	257,439	94.5	%	90.3	%
Maryland	11	9,106	8,971	864,868	864,560	94.0	%	93.3	%
Massachusetts	13	7,121	6,970	773,914	774,919	94.3	%	95.3	%
Michigan	8	4,900	4,848	615,068	616,048	94.4	%	95.5	%
Missouri	1	542	535	61,075	61,075	93.8	%	96.2	%
Nevada	3	1,823	1,819	200,612	200,407	93.8	%	93.8	%
New Hampshire	2	802	799	85,061	85,111	91.9	%	93.1	%
New Jersey	16	13,082	13,005	1,359,515	1,357,146	94.1	%	92.7	%
New Mexico	7	3,650	3,616	396,815	397,184	93.0	%	90.9	%
New York	11	10,344	10,347	868,128	874,095	93.8	%	94.1	%
Ohio	6	3,162	3,148	414,772	414,644	92.9	%	91.1	%
Oregon	1	653	655	64,970	64,970	95.6	%	97.8	%
Pennsylvania	9	6,376	6,350	699,424	697,357	92.9	%	93.8	%
Tennessee	12	6,764	6,729	868,673	879,058	95.5	%	94.5	%
Texas	13	8,535	8,488	1,131,318	1,132,221	94.3	%	96.1	%
Virginia	12	8,698	8,672	918,197	918,062	94.6	%	94.1	%
Washington, DC	1	1,694	1,547	104,454	102,492	95.6	%	93.7	%
Total Joint-Venture Stabilized	244	170,406	168,999	18,150,376	18,184,660	94.5	%	94.3	%

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

Location	Number of Stores	Company	Pro forma	Company	Pro forma	Company	Pro forma		
		Number of Units as of June 30, 2016 (1)	Number of Units as of June 30, 2015	Net Rentable Square Feet as of June 30, 2016 (2)	Net Rentable Square Feet as of June 30, 2015	Square Foot Occupancy % June 30, 2016	Square Foot Occupancy % June 30, 2015		
<b>Managed Stores</b>									
Alabama	10	5,180	4,976	681,139	672,513	90.4	%	90.1	%
Arizona	3	1,273	1,227	220,239	224,963	89.5	%	89.2	%
California	88	58,007	57,758	7,290,532	7,229,304	93.4	%	90.2	%
Colorado	17	9,411	9,133	1,118,133	1,083,803	90.1	%	93.6	%
Connecticut	1	559	459	71,983	61,385	88.9	%	95.6	%
Florida	47	31,808	31,911	3,872,471	3,889,457	94.7	%	93.5	%
Georgia	8	3,953	3,939	571,504	590,417	94.6	%	93.0	%
Hawaii	6	4,718	5,006	352,692	350,042	92.0	%	90.2	%
Illinois	10	5,693	5,719	619,499	618,732	89.9	%	85.6	%
Indiana	12	6,578	6,546	782,080	800,440	93.9	%	91.7	%
Kentucky	2	1,332	1,328	218,887	219,777	93.9	%	97.0	%
Louisiana	1	984	992	132,775	132,770	93.9	%	90.8	%
Maryland	18	13,057	12,812	1,255,175	1,251,894	92.5	%	90.6	%
Michigan	4	2,195	2,187	262,306	261,516	89.6	%	85.4	%
Mississippi	1	681	684	115,688	115,688	93.4	%	94.6	%
Missouri	4	2,143	2,037	253,041	230,380	92.5	%	87.2	%
Nevada	6	5,117	5,183	578,500	579,195	91.9	%	84.4	%
New Jersey	4	2,109	2,096	235,868	235,017	92.3	%	88.2	%
New Mexico	1	822	806	107,855	103,535	91.2	%	86.4	%
North Carolina	7	3,019	3,006	409,442	409,154	90.8	%	91.5	%
Ohio	12	4,801	4,753	620,636	626,996	94.1	%	92.5	%
Oklahoma	3	1,923	1,953	335,314	344,992	87.1	%	87.2	%
Oregon	1	447	455	39,430	39,419	97.6	%	97.7	%
Pennsylvania	13	7,006	6,952	857,533	858,782	94.3	%	93.3	%
South Carolina	4	2,609	2,599	348,578	347,681	93.1	%	88.3	%
Tennessee	2	910	909	131,600	131,360	95.5	%	95.3	%
Texas	31	16,801	16,082	2,320,698	2,219,531	89.0	%	88.3	%
Utah	5	2,549	2,536	380,122	381,077	97.1	%	94.0	%
Virginia	5	3,030	3,032	302,979	303,229	93.5	%	92.9	%
Washington	1	485	493	48,738	48,792	93.4	%	85.5	%
Puerto Rico	4	2,702	2,663	287,732	286,953	87.5	%	85.9	%
Total Managed Stabilized	331	201,902	200,232	24,823,169	24,648,794	92.6	%	90.8	%
Total Stabilized Stores	1,326	887,022	881,006	100,159,713	100,079,823	93.5	%	92.5	%

(1) Represents unit count as of June 30, 2016, which may differ from unit count as of June 30, 2015 due to unit conversions or expansions.

(2) Represents net rentable square feet as of June 30, 2016, which may differ from rentable square feet as of June 30, 2015 due to unit conversions or expansions.



The following table presents additional information regarding the occupancy of our lease-up stores by state as of June 30, 2016 and 2015. The information as of June 30, 2015 is on a pro forma basis as though all the stores owned and/or managed at June 30, 2016 were under our control as of June 30, 2015.

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

Lease-up Store Data Based on Location

Location	Number of Stores	Company Number of Units as of June 30, 2016 (1)	Pro forma Number of Units as of June 30, 2015	Company Net Rentable Square Feet as of June 30, 2016 (2)	Pro forma Net Rentable Square Feet as of June 30, 2015	Company Square Foot Occupancy % June 30, 2016	Pro forma Square Foot Occupancy % June 30, 2015		
<b>Wholly-Owned Stores</b>									
Arizona	2	1,504	895	185,737	121,993	79.2 %	53.1 %		
California (3)	2	1,222	—	131,404	—	50.0 %	— %		
Connecticut	1	1,108	1,108	89,820	89,890	95.7 %	81.1 %		
Florida	2	1,232	1,220	155,625	160,630	89.9 %	73.4 %		
Georgia	4	2,533	1,852	294,150	219,529	59.6 %	59.4 %		
Illinois	3	2,747	1,393	216,982	115,320	64.9 %	32.4 %		
Maryland	1	988	988	103,135	103,171	93.3 %	86.5 %		
Massachusetts	3	2,715	756	206,592	67,381	61.3 %	35.2 %		
North Carolina	2	1,613	977	154,441	85,235	82.9 %	56.0 %		
Oregon	1	590	636	76,797	77,225	95.2 %	9.0 %		
South Carolina	2	1,346	1,362	137,295	137,390	80.5 %	45.5 %		
Texas	8	4,958	4,290	637,046	557,118	86.3 %	62.5 %		
Virginia	1	528	455	55,515	56,805	95.0 %	79.4 %		
<b>Total Wholly-Owned in Lease-up</b>	<b>32</b>	<b>23,084</b>	<b>15,932</b>	<b>2,444,539</b>	<b>1,791,687</b>	<b>77.4 %</b>	<b>58.4 %</b>		
<b>Joint-Venture Stores</b>									
Arizona	1	600	—	62,200	—	83.4 %	— %		
California	1	640	678	59,529	59,239	90.6 %	40.9 %		
Colorado	1	815	—	84,846	—	15.5 %	— %		
New Jersey	1	872	—	74,211	—	81.3 %	— %		
New York	2	2,741	—	129,915	—	38.7 %	— %		
Texas	1	533	—	55,305	—	16.8 %	— %		
South Carolina	—	1	—	78	—	51.0 %	— %		
<b>Total Joint-Venture in Lease-up</b>	<b>8</b>	<b>6,870</b>	<b>678</b>	<b>543,731</b>	<b>59,239</b>	<b>51.2 %</b>	<b>40.9 %</b>		
<b>Managed Stores</b>									
Arizona	1	838	—	90,915	—	13.9 %	— %		
California	5	3,930	1,081	491,347	141,305	40.3 %	60.6 %		
Colorado	5	3,488	2,039	371,807	206,608	66.1 %	41.7 %		
Florida	3	2,003	850	193,939	91,145	76.9 %	65.7 %		
Georgia	2	649	553	89,858	69,422	71.3 %	29.7 %		
Illinois	4	3,048	673	282,088	46,417	29.6 %	80.0 %		
Indiana	1	109	109	16,800	16,800	68.3 %	34.2 %		
Maryland	3	1,726	1,310	144,230	114,395	82.6 %	55.0 %		
Massachusetts	1	902	902	70,106	70,076	80.8 %	25.0 %		
Minnesota	1	642	—	62,543	—	56.4 %	— %		
Missouri	1	613	—	64,865	—	7.3 %	— %		
Nevada	1	1,450	1,487	197,186	196,275	80.5 %	54.0 %		
New Hampshire	1	372	—	35,156	—	19.3 %	— %		
New Jersey	1	730	—	109,827	—	23.4 %	— %		
New York	1	533	344	56,425	33,704	58.7 %	67.9 %		
North Carolina	6	3,561	1,678	382,368	202,391	55.3 %	37.7 %		



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

Location	Number of Stores	Company	Pro forma	Company	Pro forma	Company	Pro forma		
		Number of Units as of June 30, 2016 (1)	Number of Units as of June 30, 2015	Net Rentable Square Feet as of June 30, 2016 (2)	Net Rentable Square Feet as of June 30, 2015	Square Foot Occupancy % June 30, 2016	Square Foot Occupancy % June 30, 2015		
Ohio	1	538	292	67,860	40,940	76.1	%	91.1	%
Oregon	1	269	—	27,300	—	91.1	%	—	%
South Carolina	2	1,583	1,618	165,026	165,319	87.7	%	45.7	%
Texas	1	558	—	65,409	—	38.0	%	—	%
Utah	1	407	—	44,399	—	20.3	%	—	%
Virginia	1	456	459	51,299	51,329	91.9	%	70.5	%
Washington	1	684	724	80,630	81,380	98.0	%	39.3	%
Total Managed in Lease-up	46	29,130	14,172	3,172,948	1,540,401	56.8	%	50.2	%
Total Lease-up Stores	86	59,084	30,782	6,161,218	3,391,327	64.5	%	54.4	%

(1) Represents unit count as of June 30, 2016, which may differ from unit count as of June 30, 2015 due to unit conversions or expansions.

(2) Represents net rentable square feet as of June 30, 2016, which may differ from rentable square feet as of June 30, 2015 due to unit conversions or expansions.

(3) In October 2014, a store located in Venice, California was damaged by fire. In April 2016, the first floor re-opened for operation, while the reconstruction on the second floor is pending completion.

## RESULTS OF OPERATIONS

Comparison of the three and six months ended June 30, 2016 and 2015

### Overview

Results for the three and six months ended June 30, 2016 included the operations of 1,035 stores (783 wholly-owned, two in consolidated joint ventures, and 250 in joint ventures accounted for using the equity method) compared to the results for the three and six months ended June 30, 2015, which included the operations of 866 stores (615 wholly-owned, one in a consolidated joint venture, and 250 in joint ventures accounted for using the equity method).

### Revenues

The following table presents information on revenues earned for the periods indicated:

	For the Three Months Ended June 30,				For the Six Months Ended June 30,				
	2016	2015	\$ Change	% Change	2016	2015	\$ Change	% Change	
Revenues:									
Property rental	\$211,791	\$161,024	\$50,767	31.5 %	\$411,279	\$309,918	\$101,361	32.7 %	
Tenant reinsurance	21,654	17,340	4,314	24.9 %	42,209	33,850	8,359	24.7 %	
Management fees and other income	10,828	7,496	3,332	44.5 %	20,188	15,246	4,942	32.4 %	
Total revenues	\$244,273	\$185,860	\$58,413	31.4 %	\$473,676	\$359,014	\$114,662	31.9 %	

Property Rental—The increase in property rental revenues for the three and six months ended June 30, 2016 was the result of increases of \$39,170 and \$75,977 associated with acquisitions completed in 2016 and 2015, and increases of \$11,523 and \$24,560 as a result of increases in occupancy and rental rates to new and existing customers at our

stabilized stores, respectively. Revenues at our lease-up stores increased by \$564 for the three months ended June 30, 2016 and \$1,199 for the six months ended June 30, 2016 when compared to the same periods in the prior year. We acquired 45 stores during the six months ended June 30, 2016 and 171 stores during the year ended December 2015. Occupancy at our wholly-owned stabilized stores

increased to 93.6% at June 30, 2016, as compared to 92.8% at June 30, 2015. The achieved rental rate to new tenants on wholly owned properties for the three months ended June 30, 2016 increased an average of approximately 6.4% over the same period in the prior year.

Tenant Reinsurance—The increase in our tenant reinsurance revenues was due primarily to the increase in the number of stores operated. We operated 1,412 stores at June 30, 2016 compared to 1,147 stores at June 30, 2015.

Management Fees and Other Income—Our taxable REIT subsidiary (“TRS”), Extra Space Management, Inc., manages stores owned by our joint ventures and third parties. Management fees represent approximately 6% of cash collected from these stores. We also earn an asset management fee from one of our joint ventures, equal to 0.5% of the total asset value, provided certain conditions are met. The increase in management fee revenues was due to an increase in revenues at the managed stores as a result of increases in occupancy and rental rates, and to an increase in the number of properties managed. We managed 629 stores for joint ventures and third parties as of June 30, 2016, compared to 532 stores as of June 30, 2015.

#### Expenses

The following table presents information on expenses for the periods indicated:

	For the Three Months Ended June 30,				For the Six Months Ended June 30,				
	2016	2015	\$ Change	% Change	2016	2015	\$ Change	% Change	
Expenses:									
Property operations	\$62,430	\$48,209	\$14,221	29.5 %	\$123,542	\$95,453	\$28,089	29.4 %	
Tenant reinsurance	3,941	3,283	658	20.0 %	8,252	6,211	2,041	32.9 %	
Acquisition related costs and other	3,138	4,554	(1,416)	(31.1)%	7,191	5,423	1,768	32.6 %	
General and administrative	20,512	16,655	3,857	23.2 %	43,914	32,904	11,010	33.5 %	
Depreciation and amortization	43,950	31,552	12,398	39.3 %	86,847	61,980	24,867	40.1 %	
Total expenses	\$133,971	\$104,253	\$29,718	28.5 %	\$269,746	\$201,971	\$67,775	33.6 %	

Property Operations—The increase in property operations expense during the three and six months ended June 30, 2016 was primarily the result of increases of \$13,054 and \$26,236 associated with acquisitions completed in 2016 and 2015 and increases of \$979 and \$1,701 associated with increases in expenses at our stabilized properties, respectively. The increases in expenses at our stabilized properties consisted primarily of increases in property taxes and insurance. We acquired 45 operating stores during the six months ended June 30, 2016, and 171 operating stores during the year ended December 31, 2015.

Tenant Reinsurance—Tenant reinsurance expense represents the costs that are incurred to provide tenant reinsurance. The increase was primarily due to the increase in the number of stores we owned and/or managed. June 30, 2016, we owned and/or managed 1,412 stores compared to 1,147 stores at June 30, 2015.

Acquisition Related Costs and Other—These costs relate primarily to acquisition activities during the periods indicated. The decrease in these expenses for the three month period ended June 30, 2016 compared to the prior year period was due to a decrease in the number of acquisitions. We acquired 22 properties during the three months ended June 30, 2016 compared to 31 acquisitions during the same period in the prior year. The increase in these expenses for the six months ended June 30, 2016 compared to the same period in the prior year was due to an increase in the number of acquisitions completed during these periods. We completed the acquisition of 45 stores during the six months ended June 30, 2016 compared to 39 stores during the same period in the prior year. Also included as other is \$800 related to the write down of a note receivable during the three months ended June 30, 2016.

General and Administrative—General and administrative expenses primarily include all expenses not directly related to our stores, including corporate payroll, travel and professional fees. These expenses are recognized as incurred. General and administrative expenses for the three and six months ended June 30, 2016 increased when compared to the same periods in the prior year primarily due to the overall cost associated with the management of additional stores. At June 30, 2016, we owned and/or managed 1,412 stores compared to 1,147 stores at June 30, 2015. Additionally, during the six months ended June 30, 2016, we accrued a \$4,000 expense related the potential settlement of a legal action. We did not observe any material trends in

specific payroll, travel or other expenses that contributed significantly to the increase in general and administrative expenses apart from the increase due to the management of additional stores.

Depreciation and Amortization—Depreciation and amortization expense increased as a result of the acquisition of new stores. We acquired 45 operating stores during the six months ended June 30, 2016 and 171 operating stores during 2015.

#### Other Revenues and Expenses

The following table presents information about other revenues and expenses for the periods indicated:

	For the Three Months Ended June 30,				For the Six Months Ended June 30,			
	2016	2015	\$ Change	% Change	2016	2015	\$ Change	% Change
Other income and expenses:								
Gain on real estate transactions and earnout from prior acquisition	\$11,358	\$400	\$10,958	2,739.5 %	\$9,814	\$400	\$9,414	2,353.5 %
Interest expense	(32,802 )	(22,811 )	(9,991 )	43.8 %	(64,161 )	(44,242 )	(19,919 )	45.0 %
Non-cash interest expense related to amortization of discount on equity component of exchangeable senior notes	(1,240 )	(696 )	(544 )	78.2 %	(2,473 )	(1,393 )	(1,080 )	77.5 %
Interest income	1,625	428	1,197	279.7 %	3,339	1,284	2,055	160.0 %
Interest income on note receivable from Preferred Operating Partnership unit holder	1,212	1,212	—	—	2,425	2,425	—	—
Equity in earnings of unconsolidated real estate ventures	3,358	3,001	357	11.9 %	6,188	5,651	537	9.5 %
Equity in earnings of unconsolidated real estate ventures - gain on sale of real estate assets and purchase of joint venture partners' interests	—	—	—	—	26,923	2,857	24,066	842.4 %
Income tax expense	(3,773 )	(2,185 )	(1,588 )	72.7 %	(6,538 )	(4,433 )	(2,105 )	47.5 %
Total other expense, net	\$(20,262)	\$(20,651)	\$389	(1.9 )%	\$(24,483)	\$(37,451)	\$12,968	(34.6 )%

Gain on Sale of Real Estate and Earnout from Prior Acquisition—On April 20, 2016, we closed on the sale of seven operating stores located in Ohio and Indiana that had been classified as held for sale for \$17,555 in cash. We recognized a gain of \$11,265 related to this disposition.

On April 1, 2016, we disposed of a single store in Texas in exchange for 85,452 of our OP Units valued at \$7,689. The Operating Partnership has canceled the OP Units received in this disposition. We recognized a gain of \$93 related to this disposition.



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

During 2014, we acquired a portfolio of five stores. As part of this acquisition, we agreed to make an additional cash payment to the sellers if the acquired stores exceeded a specified amount of net operating income for the years ending December 31, 2015 and 2016. At the acquisition date, we recorded an estimated liability related to this provision. The operating income of these stores during the earnout period has been higher than expected, resulting in an increase in the payment due to the sellers of \$1,544, which was recorded as a loss during the six months ended June 30, 2016.

In 2011, we acquired a single store in Florida. As part of the acquisition, we agreed to make an additional cash payment to the sellers if the acquired store exceeded a specified amount of net rental income for the period of 12 consecutive months ending

35

---

June 30, 2015. During 2014 we recorded a liability of \$2,500 as an estimate of the payment that would become due. The \$400 gain recorded during the three months ended June 30, 2015 represents the adjustment needed to true up the existing liability to the amount owed to the sellers as of June 30, 2015.

**Interest Expense**—The increase in interest expense during the three and six months ended June 30, 2016 was the result of increases in debt over the same period in the prior year. The total face value of our debt, including our lines of credit, was \$3,855,741 at June 30, 2016 compared to \$2,298,142 at June 30, 2015.

**Non-cash Interest Expense Related to Amortization of Discount on Equity Component of Exchangeable Senior Notes**—Represents the amortization of the discounts related to the equity components of the exchangeable senior notes issued by our Operating Partnership. The 2013 Notes and 2015 Notes both have an effective interest rate of 4.0% relative to the carrying amount of the liability. The increase for the three and six months ended June 30, 2016 when compared to the same periods in the prior year is due to the issuance of \$575,000 principal amount of the 2015 Notes in September 2015.

**Interest Income**—Interest income represents amounts earned on cash and cash equivalents deposited with financial institutions and interest earned on notes receivable. The increases for the three and six months ended June 30, 2016 related primarily to the increase in notes receivable when compared to the same periods in the prior year. We had \$53,593 of notes receivable included in other assets on the condensed consolidated balance sheets as of June 30, 2016, compared to \$0 as of June 30, 2015. The increase was due to a note receivable of \$84,331 that we issued on October 1, 2015 related to the acquisition of SmartStop Self Storage LLC and related transactions. During the three months ended June 30, 2016, we received a partial payment on the note receivable of \$30,738.

**Interest Income on Note Receivable from Preferred Operating Partnership Unit Holders**—Represents interest on a \$100,000 loan to the holders of the Series A Participating Redeemable Preferred Units of our Operating Partnership (“Series A Units”).

**Equity in Earnings of Unconsolidated Real Estate Ventures**—Equity in earnings of unconsolidated real estate ventures represents the income earned through our ownership interests in unconsolidated joint ventures. The increases for the three and six months ended June 30, 2016 compared to the same periods in the prior year were primarily the result of increases in revenue at the stores owned by the joint ventures. This increase was offset by the lower income in our VRS joint venture (defined below) due to the joint venture having six fewer stores subsequent to our acquisition of these stores on February 2, 2016.

On April 25, 2016, we and Prudential entered into the “Second Amendment to Amended and Restated Operating Agreement of ESS PRISA LLC” and the “First Amendment to Amended and Restated Operating Agreement of ESS PRISA II LLC” (the “Amendments”). The Amendments are deemed effective as of April 1, 2016. Under the Amendments, we gave up any future rights to receive distributions from these joint ventures at the higher “excess profit participation” percentage of 17.0% in exchange for a higher equity ownership percentage. Our equity ownership in ESS PRISA LLC increased from 2.0% to 4.0%, and our equity ownership in ESS PRISA II LLC increased from 2.0% to 4.4%. We will continue to account for our investment in these joint ventures under the equity method of accounting.

**Equity in Earnings of Unconsolidated Real Estate Ventures—Gain on Sale of Real Estate Assets and Purchase of Joint Venture Partners’ Interests**—On February 2, 2016, we acquired six stores from our VRS Self Storage LLC joint venture (“VRS”) in a step acquisition. We own 45.04% of VRS, with the other 54.96% owned by affiliates of Prudential Real Estate (“Prudential”). VRS created a new subsidiary, Extra Space Properties 122 LLC (“ESP 122”) and transferred six stores into ESP 122. VRS then distributed ESP 122 to Prudential and us on a pro rata basis. This distribution was accounted for as a spinoff, and was therefore recorded at the net carrying amount of the properties of \$17,261. Immediately after the distribution, we acquired Prudential’s 54.96% interest in ESP 122 for \$53,940, resulting in 100%

ownership of ESP 122 and the related six stores. Based on the purchase price of Prudential's share of ESP 122, we determined that the fair value of our investment in ESP 122 immediately prior to the acquisition of Prudential's share was \$44,184, and we recorded a gain of \$26,923 as a result of re-measuring to fair value our existing equity interest in ESP 122.

During March 2015, one of our joint ventures sold a store located in New York to a third party and recognized a gain of \$60,495. We recognized our 2.0% share of this gain, or \$1,228.

Additionally, in March 2015 we acquired a joint venture partner's 82.4% equity interest in an existing joint venture. We previously held the remaining 17.6% equity interest in this joint venture. Prior to the acquisition, we accounted for our equity interest in this joint venture as an equity-method investment. We recognized a non-cash gain of \$1,629 as a result of re-measuring the fair value of our equity interest in this joint venture held before the acquisition.

Income Tax Expense—For the three and six months ended June 30, 2016, the increases in income tax expense is the result of an increase in income earned by our “TRS” when compared to the same periods in the prior year.

#### Net Income Allocated to Noncontrolling Interests

The following table presents information on net income allocated to noncontrolling interests for the periods indicated:

	For the Three Months Ended June 30,				For the Six Months Ended June 30,			
	2016	2015	\$ Change	% Change	2016	2015	\$ Change	% Change
Net income allocated to noncontrolling interests:								
Net income allocated to Preferred Operating Partnership noncontrolling interests	\$(3,434)	\$(3,007)	\$(427)	14.2 %	\$(6,614)	\$(5,933)	\$(681)	11.5 %
Net income allocated to Operating Partnership and other noncontrolling interests	(3,562)	(2,610)	(952)	36.5 %	(7,197)	(4,578)	(2,619)	57.2 %
Total income allocated to noncontrolling interests:	\$(6,996)	\$(5,617)	\$(1,379)	24.6 %	\$(13,811)	\$(10,511)	\$(3,300)	31.4 %

Net Income Allocated to Preferred Operating Partnership Noncontrolling Interests—Income allocated to the Preferred Operating Partnership noncontrolling interests for the three and six months ended June 30, 2016 represents the fixed distributions paid to holders of the Series A Units, Series B Units, Series C Units and Series D Units, plus approximately 0.65% of the remaining net income allocated to holders of the Series A Units.

Net Income Allocated to Operating Partnership and Other Noncontrolling Interests—Income allocated to the Operating Partnership represents approximately 4.1% and 4.5% of net income after the allocation of the fixed distribution paid to the Preferred Operating Partnership unit holders for the three and six months ended June 30, 2016 and 2015, respectively.

#### FUNDS FROM OPERATIONS

Funds from Operations (“FFO”) provides relevant and meaningful information about our operating performance that is necessary, along with net income and cash flows, for an understanding of our operating results. We believe FFO is a meaningful disclosure as a supplement to net earnings. Net earnings assume that the values of real estate assets diminish predictably over time as reflected through depreciation and amortization expenses. The values of real estate assets fluctuate due to market conditions and we believe FFO more accurately reflects the value of our real estate assets. FFO is defined by the National Association of Real Estate Investment Trusts, Inc. (“NAREIT”) as net income computed in accordance with GAAP, excluding gains or losses on sales of operating stores and impairment write downs of depreciable real estate assets, plus depreciation and amortization and after adjustments to record unconsolidated partnerships and joint ventures on the same basis. We believe that to further understand our performance, FFO should be considered along with the reported net income and cash flows in accordance with GAAP, as presented in our condensed consolidated financial statements.

The computation of FFO may not be comparable to FFO reported by other REITs or real estate companies that do not define the term in accordance with the current NAREIT definition or that interpret the current NAREIT definition differently. FFO does not represent cash generated from operating activities determined in accordance with GAAP, and should not be considered as an alternative to net income as an indication of our performance, as an alternative to net cash flow from operating activities, as a measure of liquidity, or an indicator of our ability to make cash distributions.

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

The following table presents the calculation of FFO for the periods indicated:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2016	2015	2016	2015
Net income attributable to common stockholders	\$83,044	\$55,339	\$165,636	\$109,081
Adjustments:				
Real estate depreciation	37,388	27,311	73,824	53,429
Amortization of intangibles	4,836	2,444	9,572	5,241
Gain on real estate transactions and earnout from prior acquisition	(11,358 )	(400 )	(9,814 )	(400 )
Unconsolidated joint venture real estate depreciation and amortization	1,239	1,058	2,254	2,115
Unconsolidated joint venture gain on sale of real estate and purchase of partners' interests	—	—	(26,923 )	(2,857 )
Distributions paid on Series A Preferred Operating Partnership units	(1,271 )	(1,271 )	(2,542 )	(2,545 )
Income allocated to Operating Partnership noncontrolling interests	6,996	5,608	13,812	10,501
Funds from operations attributable to common stockholders	\$120,874	\$90,089	\$225,819	\$174,565

#### SAME-STORE RESULTS

We consider our same-store stabilized portfolio to consist of only those stores that were wholly-owned at the beginning and at the end of the applicable periods presented that have achieved stabilization as of the first day of such period. The following table presents operating data for our same-store portfolio. We consider the following same-store presentation to be meaningful in regards to the stores shown below because these results provide information relating to store-level operating changes without the effects of acquisitions or completed developments.

	For the Three Months Ended June 30,		Percent	For the Six Months Ended June 30,		Percent
	2016	2015	Change	2016	2015	Change
Same-store rental and tenant reinsurance revenues	\$176,641	\$164,190	7.6 %	\$347,112	\$320,423	8.3 %
Same-store operating and tenant reinsurance expenses	47,904	46,475	3.1 %	96,481	94,149	2.5 %
Same-store net operating income	\$128,737	\$117,715	9.4 %	\$250,631	\$226,274	10.8 %
Non same-store rental and tenant reinsurance revenues	\$56,804	\$14,174	300.8 %	\$106,376	\$23,345	355.7 %
Non same-store operating and tenant reinsurance expenses	\$18,467	\$5,017	268.1 %	\$35,313	\$7,515	369.9 %
Total rental and tenant reinsurance revenues	\$233,445	\$178,364	30.9 %	\$453,488	\$343,768	31.9 %
Total operating and tenant reinsurance expenses	\$66,371	\$51,492	28.9 %	\$131,794	\$101,664	29.6 %
Same-store square foot occupancy as of quarter end	94.4 %	94.4 %	%	94.4 %	94.4 %	%
Properties included in same-store	564	564		564	564	



Same-store revenues for the three months ended June 30, 2016 increased due to gains in occupancy and higher rental rates for both new and existing customers. Expenses were higher for the three months ended June 30, 2016 due to increases in repairs and maintenance expense, property taxes and insurance. For the six months ended June 30, 2016, expenses were higher due to increases in tenant reinsurance expense, property taxes and insurance. Increases in expenses were partially offset by decreases in utility expense in both periods, and repairs and maintenance expense for the six months ended June 30, 2016.

## CASH FLOWS

Cash flows provided by operating activities were \$239,670 and \$183,287, respectively for the six months ended June 30, 2016 and 2015. The increase was primarily due to an increase in net income of \$59,855, and an increase in depreciation and amortization of \$24,867. These increases were offset by a non-cash gain on the purchase of joint venture partners' interests of \$26,923. This non-cash gain was the result of a step acquisition of six stores that were previously owned by our VRS joint venture.

Cash used in investing activities was \$405,992 and \$252,789, respectively, for the six months ended June 30, 2016 and 2015. The increase was primarily due to an increase in cash paid for the acquisition of real estate assets of \$194,406. We purchased 45 stores during the six months ended June 30, 2016, compared to only 39 stores purchased during the six months ended June 30, 2015. This increase was offset by an increase in cash received from principal payments on notes receivable of \$41,393 for the six months ended June 30, 2016 when compared to the same period in 2015.

Cash provided by financing activities was \$131,581 and \$197,732, respectively, for the six months ended June 30, 2016 and 2015. The change related primarily to a decrease in net proceeds from the sale of common stock of \$343,274, a decrease in principal payments on notes payable and lines of credit of \$750,733 and a decrease in proceeds from notes payable and lines of credit of \$399,260 for the six months ended June 30, 2016 when compared to the same period in the prior year. These decreases were partially offset by an increase in the cash paid for the repurchase of exchangeable senior notes of \$22,192, and an increase in the cash paid for dividends of \$48,041.

## LIQUIDITY AND CAPITAL RESOURCES

As of June 30, 2016, we had \$41,058 available in cash and cash equivalents. We intend to use this cash for acquisitions, to repay debt and for general corporate purposes. We are required to distribute at least 90% of our net taxable income, excluding net capital gains, to our stockholders on an annual basis to maintain our qualification as a REIT.

Our cash and cash equivalents are held in accounts managed by third party financial institutions and consist of invested cash and cash in our operating accounts. During 2015 and the first six months of 2016, we experienced no loss or lack of access to our cash or cash equivalents; however, there can be no assurance that access to our cash and cash equivalents will not be impacted by adverse conditions in the financial markets.

The following table presents information on our lines of credit for the period presented. All of our lines of credit are guaranteed by us and secured by mortgages on certain real estate assets.

Line of Credit	As of June 30, 2016						
	Amount Drawn	Capacity	Interest Rate	Origination Date	Maturity	Basis Rate (1)	Notes
Credit Line 1	\$88,000	\$180,000	2.1 %	6/4/2010	6/30/2018	LIBOR plus 1.7%	(2)
Credit Line 2	—	50,000	2.2 %	11/16/2010	2/13/2017	LIBOR plus 1.8%	(3)



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

Credit Line 3	—	80,000	2.1 %	4/29/2011	11/18/2016	LIBOR plus 1.7%	(3)
Credit Line 4	—	50,000	2.1 %	9/29/2014	9/29/2017	LIBOR plus 1.7%	(3)
		\$88,000		\$360,000			

(1) 30-day USD LIBOR

(2) One two-year extension available

(3) Two one-year extensions available

As of June 30, 2016, we had \$3,855,741 face value of debt, resulting in a debt to total enterprise value ratio of 23.8%. As of June 30, 2016, the ratio of total fixed-rate debt and other instruments to total debt was 78.0% (including \$2,217,322 on which we have interest rate swaps that have been included as fixed-rate debt). The weighted average interest rate of the total of fixed- and variable-rate debt at June 30, 2016 was 3.1%. Certain of our real estate assets are pledged as collateral for our debt. We are subject to certain restrictive covenants relating to our outstanding debt. We were in compliance with all financial covenants at June 30, 2016.

We expect to fund our short-term liquidity requirements, including operating expenses, recurring capital expenditures, dividends to stockholders, distributions to holders of Operating Partnership units and interest on our outstanding indebtedness, out of our operating cash flow, cash on hand and borrowings under our lines of credit. In addition, we are pursuing additional term loans secured by unencumbered stores.

Our liquidity needs consist primarily of cash distributions to stockholders, store acquisitions, principal payments under our borrowings and non-recurring capital expenditures. We may from time to time seek to repurchase our outstanding debt, shares of common stock or other securities in open market purchases, privately negotiated transactions or otherwise. Such repurchases, if any, will depend on prevailing market conditions, our liquidity requirements, contractual restrictions and other factors. In addition, we evaluate, on an ongoing basis, the merits of strategic acquisitions and other relationships, which may require us to raise additional funds. We do not expect that our operating cash flow or cash balances will be sufficient to fund our liquidity needs and instead expect to fund such needs out of additional borrowings of secured or unsecured indebtedness, joint ventures with third parties, and from the proceeds of public and private offerings of equity and debt. Additional capital may not be available on terms favorable to us or at all. Any additional issuance of equity or equity-linked securities may result in dilution to our stockholders. In addition, any new securities we issue could have rights, preferences and privileges senior to holders of our common stock. We may also use Operating Partnership units as currency to fund acquisitions from self-storage owners who desire tax-deferral in their exiting transactions.

#### OFF-BALANCE SHEET ARRANGEMENTS

Except as disclosed in the notes to our consolidated financial statements of our most recently filed Annual Report on Form 10-K, we do not currently have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purposes entities, which typically are established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. Further, except as disclosed in the notes to our condensed consolidated financial statements, we have not guaranteed any obligations of unconsolidated entities, nor do we have any commitments or intent to provide funding to any such entities. Accordingly, we are not materially exposed to any financing, liquidity, market or credit risk that could arise if we had engaged in these relationships.

#### FINANCING STRATEGY

We will continue to employ leverage in our capital structure in amounts reviewed from time to time by our board of directors. Although our board of directors has not adopted a policy that limits the total amount of indebtedness that we may incur, we will consider a number of factors in evaluating our level of indebtedness from time to time, as well as the amount of such indebtedness that will be either fixed- or variable-rate. In making financing decisions, we will consider factors including but not limited to:

- the interest rate of the proposed financing;
- the extent to which the financing impacts flexibility in managing our stores;
- prepayment penalties and restrictions on refinancing;
- the purchase price of stores acquired with debt financing;

- long-term objectives with respect to the financing;
- target investment returns;
- the ability of particular stores, and our company as a whole, to generate cash flow sufficient to cover expected debt service payments;
- overall level of consolidated indebtedness;
- timing of debt and lease maturities;
- provisions that require recourse and cross-collateralization;

corporate credit ratios including debt service coverage, debt to total capitalization and debt to undepreciated assets; and  
the overall ratio of fixed- and variable-rate debt.

Our indebtedness may be recourse, non-recourse or cross-collateralized. If the indebtedness is non-recourse, the collateral will be limited to the particular stores to which the indebtedness relates. In addition, we may invest in stores subject to existing loans collateralized by mortgages or similar liens on our stores, or we may refinance stores acquired on a leveraged basis. We may use the proceeds from any borrowings to refinance existing indebtedness, to refinance investments, including the redevelopment of existing stores, for general working capital or to purchase additional interests in partnerships or joint ventures or for other purposes when we believe it is advisable.

Typically, we invest in or form consolidated special purpose entities to assist us in obtaining secured permanent financing at attractive terms. Permanent financing may be structured as a mortgage loan on a single property, or on a group of properties, and generally requires us to provide a mortgage lien on the property or properties in favor of an institutional third party, as a joint venture with a third party, or as a securitized financing. For securitized financings, we create special purpose entities to own the properties. These special purpose entities, which are common in the real estate industry, are structured so that they would not be consolidated in a bankruptcy proceeding involving a parent company. We decide upon the structure of the financing based upon the best terms then available to us and whether the proposed financing is consistent with our other business objectives. For accounting purposes, we include the outstanding securitized debt of special purpose entities owning consolidated properties as part of our consolidated indebtedness.

We may from time to time seek to retire or repurchase our outstanding debt, as well as shares of common stock or other securities in open market purchases, privately negotiated transactions or otherwise. Such repurchases, if any, will depend on prevailing market conditions, our liquidity requirements, contractual restrictions and other factors. The amounts involved may be material.

#### SEASONALITY

The self-storage business is subject to seasonal fluctuations. A greater portion of revenues and profits are realized from May through September. Historically, our highest level of occupancy has been at the end of July, while our lowest level of occupancy has been in late February and early March. Results for any quarter may not be indicative of the results that may be achieved for the full fiscal year.

#### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Amounts in thousands, except store and share data, unless otherwise stated

##### Market Risk

Market risk refers to the risk of loss from adverse changes in market prices and interest rates. Our future income, cash flows and fair values of financial instruments are dependent upon prevailing market interest rates.

##### Interest Rate Risk

Interest rate risk is highly sensitive to many factors, including governmental monetary and tax policies, domestic and international economic and political considerations and other factors beyond our control.

As of June 30, 2016, we had \$3,855,741 in total face value of debt, of which \$763,425 was subject to variable interest rates without floors or caps (excluding debt with interest rate swaps). If LIBOR were to increase or decrease by 100 basis points, the increase or decrease in interest expense on the variable-rate debt (excluding variable-rate debt with

interest rate floors) would increase or decrease future earnings and cash flows by \$7,634 annually.

Interest rate risk amounts were determined by considering the impact of hypothetical interest rates on our financial instruments. These analyses do not consider the effect of any change in overall economic activity that could occur. Further, in the event of a change of that magnitude, we may take actions to further mitigate our exposure to the change. However, due to the uncertainty of the specific actions that would be taken and their possible effects, these analyses assume no changes in our financial structure.

The fair values of our fixed-rate assets and liabilities were as follows for the periods indicated:

	June 30, 2016		December 31, 2015	
	Fair Value	Carrying Value	Fair Value	Carrying Value
Notes receivable from Preferred Operating Partnership unit holders	\$ 131,701	\$ 120,230	\$ 128,216	\$ 120,230
Fixed rate notes receivable	\$ 54,825	\$ 53,593	\$ 86,814	\$ 84,331
Fixed rate notes payable and notes payable to trusts	\$ 2,446,724	\$ 2,367,687	\$ 1,828,486	\$ 1,806,904
Exchangeable senior notes	\$ 760,594	\$ 638,172	\$ 770,523	\$ 660,364

The fair value of our note receivable from Preferred Operating Partnership unit holders and other notes receivable was based on the discounted estimated future cash flows of the note (categorized within Level 3 of the fair value hierarchy); the discount rate used approximated the current market rate for loans with similar maturities and credit quality. The fair values of our fixed-rate notes payable and notes payable to trusts were estimated using the discounted estimated future cash payments to be made on such debt (categorized within Level 3 of the fair value hierarchy); the discount rates used approximated current market rates for loans, or groups of loans, with similar maturities and credit quality. The fair value of our exchangeable senior notes was estimated using an average market price for similar securities obtained from a third party.

#### ITEM 4. CONTROLS AND PROCEDURES

##### (1) Disclosure Controls and Procedures

We maintain disclosure controls and procedures to ensure that information required to be disclosed in the reports we file pursuant to the Securities Exchange Act of 1934, as amended, or the Exchange Act, are recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure based on the definition of “disclosure controls and procedures” in Rule 13a-15(e) of the Exchange Act. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can only provide a reasonable assurance of achieving the desired control objectives, and in reaching a reasonable level of assurance, management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

We have a disclosure committee that is responsible for considering the materiality of information and determining our disclosure obligations a timely basis. The disclosure committee meets quarterly and reports directly to our Chief Executive Officer and Chief Financial Officer.

We carried out an evaluation, under the supervision and with the participation of management, including our Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this report. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level as of the end of the period covered by this report.

##### (2) Changes in internal control over financial reporting

There were no changes in our internal control over financial reporting (as such term is defined in Exchange Act Rule 13a-15(f)) that occurred during our most recent quarter that have materially affected, or are reasonably likely to

materially affect, our internal control over financial reporting.

## PART II. OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

We are involved in various legal proceedings and are subject to various claims and complaints arising in the ordinary course of business. Because litigation is inherently unpredictable, the outcome of these matters cannot presently be determined with any degree of certainty. In accordance with applicable accounting guidance, management establishes an accrued liability for litigation when those matters present loss contingencies that are both probable and reasonably estimable. In such cases, there may be an exposure to loss in excess of any amounts accrued. The estimated loss, if any, is based upon currently available information and is subject to significant judgment, a variety of assumptions, and known and unknown uncertainties. Therefore, any estimate(s) of loss disclosed below represents what management believes to be an estimate of loss only for certain matters meeting these criteria and does not represent our maximum loss exposure. We could in the future incur judgments or enter into settlements of claims that could have a material adverse effect on our results of operations in any particular period, notwithstanding the fact that we are currently vigorously defending any legal proceedings against us.

We currently have a legal proceeding pending against us that includes causes of action alleging wrongful foreclosure, violations of various state specific self-storage statutes, and violations of various consumer fraud acts. As a result of this litigation matter, we recorded a liability of \$4,000 in March 2016, which is included in other liabilities on the condensed consolidated balance sheet.

### ITEM 1A. RISK FACTORS

There have been no material changes in our risk factors from those disclosed in our 2015 Annual Report on Form 10-K.

### ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

On June 10, 2016, our Operating Partnership issued 2,201,467 Series D-3 Preferred Units in connection with the acquisition of four stores located in Illinois. The stores were acquired in exchange for the Series D-3 Preferred Units, valued at \$55.0 million.

On June 30, 2016, our Operating Partnership issued common OP Units in connection with the acquisition of a store located in Georgia. The store was acquired in exchange for the common OP Units, valued at \$1.2 million, and approximately \$5.7 million of cash.

The terms of the common and preferred OP Units are governed by the Operating Partnership's Fourth Amended and Restated Agreement of Limited Partnership. The common and preferred OP Units will be redeemable at the option of the holders on the first anniversary of the date of issuance, which redemption obligation may be satisfied, at our option, in cash or shares of our common stock. The Series D-3 Preferred Units are also exchangeable for common OP Units until the 10<sup>th</sup> anniversary of the date of issuance.

The common and preferred OP Units were issued to accredited investors in private placements in reliance on Section 4(a)(2) of the Securities Act of 1933, as amended, and the rules and regulations promulgated thereunder.

### ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.



ITEM 4. MINE SAFETY DISCLOSURES

Not Applicable.

ITEM 5. OTHER INFORMATION

None.

43

---

ITEM 6. EXHIBITS

- 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certifications of the Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.  
The following materials from Extra Space Storage Inc.'s Quarterly Report on Form 10-Q for the quarter ended June 30, 2016 are formatted in XBRL (eXtensible Business Reporting Language): (1) the Condensed Consolidated Balance Sheets, (2) the Condensed Consolidated Statements of Operations, (3) the Condensed Consolidated Statements of Comprehensive Income (4) the Condensed Consolidated Statement of Noncontrolling Interests and Equity, (5) the Condensed Consolidated Statements of Cash Flows and (6) notes to these financial statements.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

EXTRA SPACE STORAGE INC.

Registrant

Date: August 5, 2016 /s/ Spencer F. Kirk

Spencer F. Kirk

Chief Executive Officer

(Principal Executive Officer)

Date: August 5, 2016 /s/ P. Scott Stubbs

P. Scott Stubbs

Executive Vice President and Chief Financial Officer

(Principal Financial Officer)