

Extra Space Storage Inc.
Form 10-Q
August 08, 2007

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2007

or

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

For the transition period from to .

Commission File Number: 001-32269

EXTRA SPACE STORAGE INC.

(Exact name of registrant as specified in its charter)

Maryland

(State or other jurisdiction of incorporation or organization)

20-1076777

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

**2795 East Cottonwood Parkway, Suite 400
Salt Lake City, Utah 84121**

(Address of principal executive offices)

Registrant's telephone number, including area code: **(801) 562-5556**

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 **x** No **o**

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

Large accelerated filer **x**

Accelerated filer **o**

Non-accelerated filer **o**

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, 2007 was 64,837,892.

EXTRA SPACE STORAGE INC.
TABLE OF CONTENTS

<u>STATEMENT ON FORWARD-LOOKING INFORMATION</u>	3
<u>PART I. FINANCIAL INFORMATION</u>	4
<u>ITEM 1. FINANCIAL STATEMENTS</u>	4
<u>ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	23
<u>ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	34
<u>ITEM 4. CONTROLS AND PROCEDURES</u>	35
<u>PART II. OTHER INFORMATION</u>	35
<u>ITEM 1. LEGAL PROCEEDINGS</u>	35
<u>ITEM 1A. RISK FACTORS</u>	35
<u>ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS</u>	35
<u>ITEM 3. DEFAULTS UPON SENIOR SECURITIES</u>	36
<u>ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS</u>	36
<u>ITEM 5. OTHER INFORMATION</u>	36
<u>ITEM 6. EXHIBITS</u>	36
<u>SIGNATURES</u>	37

STATEMENT ON FORWARD-LOOKING INFORMATION

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

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

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

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

- changes in general economic conditions and in the markets in which we operate;
- the effect of competition from new self-storage facilities or other storage alternatives, which could cause rents and occupancy rates to decline;
- potential liability for uninsured losses and environmental contamination;
- difficulties in our ability to evaluate, finance and integrate acquired and developed properties into our existing operations and to lease up those properties, which could adversely affect our profitability;
- 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, which could increase our expenses and reduce our cash available for distribution;
- difficulties in raising capital at reasonable rates, which could impede our ability to grow;
- delays in the development and construction process, which could adversely affect our profitability; and
- economic uncertainty due to the impact of war or terrorism, which could adversely affect our business plan.

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

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

	June 30, 2007 (unaudited)	December 31, 2006
Assets:		
Real estate assets:		
Net operating real estate assets	\$ 1,641,120	\$ 1,382,055
Real estate under development	35,906	35,336
Net real estate assets	1,677,026	1,417,391
Investments in real estate ventures	91,303	88,115
Cash and cash equivalents	45,790	70,801
Short-term investments	90,331	
Restricted cash	35,528	44,282
Receivables from related parties and affiliated real estate joint ventures	8,321	15,880
Other assets, net	35,640	33,356
Total assets	\$ 1,983,939	\$ 1,669,825
Liabilities, Minority Interests, and Stockholders' Equity:		
Notes payable	\$ 875,730	\$ 828,584
Notes payable to trusts	119,590	119,590
Exchangeable senior notes	250,000	
Line of credit		
Derivative instrument associated with Preferred Operating Partnership units (Note 14)	15,268	
Accounts payable and accrued expenses	25,363	25,704
Other liabilities	22,960	17,234
Total liabilities	1,308,911	991,112
Commitments and contingencies		
Preferred Operating Partnership units, net of \$100,000 note receivable (Note 14)	6,465	
Minority interest in Operating Partnership	37,020	34,841
Other minority interests	277	317
Stockholders' equity:		
Preferred stock, \$0.01 par value, 50,000,000 shares authorized, no shares issued or outstanding		
Common Stock, \$0.01 par value, 200,000,000 shares authorized, 64,833,425 and 64,167,098 shares issued and outstanding at June 30, 2007 and December 31, 2006, respectively	649	642
Paid-in capital	824,088	822,181
Accumulated deficit	(193,471)	(179,268)
Total stockholders' equity	631,266	643,555
Total liabilities, Preferred Operating Partnership, minority interests, and stockholders' equity	\$ 1,983,939	\$ 1,669,825

See accompanying notes to unaudited condensed consolidated financial statements.

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

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
Revenues:				
Property rental	\$ 48,392	\$ 42,020	\$ 94,623	\$ 81,195
Management and franchise fees	5,143	5,181	10,351	10,340
Tenant insurance	2,688	971	4,831	1,892
Development fees	182	175	237	225
Other income	145	184	284	249
Total revenues	56,550	48,531	110,326	93,901
Expenses:				
Property operations	17,352	15,248	34,248	29,990
Tenant insurance	1,217	589	2,190	1,222
Unrecovered development and acquisition costs	159	24	409	342
General and administrative	8,968	8,747	18,208	17,992
Depreciation and amortization	9,123	9,057	17,919	18,333
Total expenses	36,819	33,665	72,974	67,879
Income before interest, minority interests and equity in earnings of real estate ventures	19,731	14,866	37,352	26,022
Interest expense	(15,437)	(12,784)	(28,833)	(24,769)
Interest income	3,668	148	5,116	630
Minority interest - Operating Partnership	(515)	(225)	(899)	(279)
Minority interests - other	56		40	
Equity in earnings of real estate ventures	1,192	1,087	2,389	2,226
Net income	\$ 8,695	\$ 3,092	\$ 15,165	\$ 3,830
Net income per common share				
Basic	\$ 0.13	\$ 0.06	\$ 0.24	\$ 0.07
Diluted	\$ 0.13	\$ 0.06	\$ 0.23	\$ 0.07
Weighted average number of shares				
Basic	64,439,138	51,625,135	64,356,827	51,606,618
Diluted	69,248,845	55,991,088	69,214,313	55,983,086
Cash dividends paid per common share	\$ 0.23	\$ 0.23	\$ 0.46	\$ 0.46

See accompanying notes to unaudited condensed consolidated financial statements.

Extra Space Storage Inc.
Condensed Consolidated Statement of Stockholders Equity
(in thousands, except share data)
(unaudited)

	Common Stock Shares	Par Value	Paid-in Capital	Accumulated Deficit	Total Stockholders Equity
Balances at December 31, 2006	64,167,098	\$ 642	\$ 822,181	\$ (179,268)	\$ 643,555
Issuance of common stock upon the exercise of options	76,048	1	1,032		1,033
Restricted stock grants issued	90,529	1			1
Restricted stock grants cancelled	(600)				
Conversion of Contingent Conversion Shares to common stock	500,350	5			5
Compensation expense related to stock-based awards			875		875
Net income				15,165	15,165
Dividends paid on common stock at \$0.455 per share				(29,368)	(29,368)
Balances at June 30, 2007	64,833,425	\$ 649	\$ 824,088	\$ (193,471)	\$ 631,266

See accompanying notes to unaudited condensed consolidated financial statements.

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

	Six months ended June 30,	
	2007	2006
Cash flows from operating activities:		
Net income	\$ 15,165	\$ 3,830
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	17,919	18,333
Amortization of deferred financing costs	1,560	1,546
Stock compensation expense	875	1,016
Income allocated to minority interests	859	279
Distributions from operations of real estate ventures in excess of earnings	2,332	2,280
Changes in operating assets and liabilities:		
Receivables from related parties	7,559	11,890
Other assets	3,353	5,349
Accounts payable and accrued expenses	(341)	(8,775)
Other liabilities	2,624	516
Net cash provided by operating activities	51,905	36,264
Cash flows from investing activities:		
Acquisition of real estate assets	(98,148)	(87,964)
Development and construction of real estate assets	(19,381)	(15,118)
Proceeds from sale of real estate assets		728
Investments in real estate ventures	(6,022)	(4,835)
Net purchases of short-term investments	(90,331)	
Change in restricted cash	8,754	(11)
Principal payments received on notes receivable		118
Purchase of equipment and fixtures	(501)	(768)
Net cash used in investing activities	(205,629)	(107,850)
Cash flows from financing activities:		
Proceeds from exchangeable senior notes	250,000	
Proceeds from notes payable, notes payable to trusts and line of credit	46,147	97,602
Principal payments on notes payable and line of credit	(30,137)	(24,598)
Deferred financing costs	(6,408)	(647)
Loan to Preferred Operating Partnership unit holder	(100,000)	
Redemption of Operating Partnership units held by minority interest	(775)	
Net proceeds from exercise of stock options	1,033	127
Dividends paid on common stock	(29,368)	(23,561)
Distributions to Operating Partnership units held by minority interest	(1,779)	(1,740)
Net cash provided by financing activities	128,713	47,183
Net decrease in cash and cash equivalents	(25,011)	(24,403)
Cash and cash equivalents, beginning of the period	70,801	28,653
Cash and cash equivalents, end of the period	\$ 45,790	\$ 4,250

	Six months ended June 30,	
	2007	2006
Supplemental schedule of cash flow information		
Interest paid, net of amounts capitalized	\$ 24,931	\$ 22,900
Supplemental schedule of noncash investing and financing activities:		
Acquisitions:		
Real estate assets	\$ 157,079	\$ 21,009
Notes payable	(31,010)	(7,926)
Notes receivable		(10,298)
Preferred Operating Partnership units	(121,733)	
Investment in real estate ventures	(502)	(2,785)
Minority interest in Operating Partnership	(3,834)	

See accompanying notes to unaudited condensed consolidated financial statements.

Extra Space Storage Inc.

Notes to Condensed Consolidated Financial Statements (unaudited)

Amounts in thousands, except share data

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 and develop self-storage facilities located throughout the United States. The Company continues the business of Extra Space Storage LLC and its subsidiaries, which had engaged in the self-storage business since 1977. The Company's interest in its properties is held through its operating partnership, Extra Space Storage LP (the Operating Partnership), which was formed on May 5, 2004. The Company's primary assets are general partner and limited partner interests in the Operating Partnership. This structure is commonly referred to as an umbrella partnership REIT, 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 self-storage facilities by acquiring or developing wholly-owned facilities or facilities held through joint ventures with third parties. At June 30, 2007, the Company had direct and indirect equity interests in 585 storage facilities located in 33 states and Washington, D.C.

The Company operates in two distinct segments: (1) property management, acquisition and development; and (2) rental operations. The Company's property management, acquisition and development activities include managing, acquiring, developing and selling self-storage facilities. The rental operations activities include rental operations of self-storage facilities. No single tenant accounts for more than 5% of rental income.

2. BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements of the Company have been prepared 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 do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and six months ended June 30, 2007 are not necessarily indicative of results that may be expected for the year ending December 31, 2007. The Condensed Consolidated Balance Sheet as of December 31, 2006 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, 2006 as filed with the Securities and Exchange Commission (SEC).

Certain amounts in the 2006 financial statements and supporting note disclosures have been reclassified to conform to the current year presentation. Such reclassification did not impact previously reported net income or accumulated deficit.

Recently Issued Accounting Standards

Emerging Issues Task Force (EITF) Topic D-109, *Determining the Nature of a Host Contract Related to a Hybrid Financial Instrument Issued in the Form of a Share under FASB Statement No. 133* (Topic D-109), discussed at the March 15, 2007 EITF meeting, is effective at the beginning of the first fiscal quarter beginning after June 15, 2007 (even if that period is other than the first fiscal quarter of the registrant's fiscal year). Topic D-109 provides the SEC staff's view as to how one must evaluate whether a preferred stock host contract is a debt host or an equity host. It states that the determination of the nature of the host contract for a hybrid financial instrument (that is, whether the nature of the host contract is more akin to debt or to equity) issued in the form of a share should be based on a consideration of economic characteristics and risks. The SEC staff believes that the consideration of the economic characteristics and risks of the host contract should be based on all the stated and implied substantive terms and features of the hybrid financial instrument. This may represent a change from the way these instruments were analyzed in the past.

The Company has elected to early adopt Topic D-109 which specifically relates to the AAAAA Rent-A-Space acquisition that was completed during the quarter ended June 30, 2007. See Note 14.

3. NET INCOME PER SHARE

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

The Company has \$250.0 million of exchangeable senior notes issued and outstanding that also can potentially have a dilutive effect on its earnings per share calculations. The exchangeable senior notes are exchangeable by holders into shares of the Company's common stock under certain circumstances per the terms of the indenture governing the exchangeable senior notes. The exchangeable senior notes are not exchangeable unless the price of the Company's common stock is greater than or equal to 130% of the applicable exchange price for a specified period during a quarter, or unless certain other events occur. The exchange price was \$23.48 per share at June 30, 2007, and could change over time as described in the indenture. The price of the Company's common stock did not exceed 130% of the exchange price for the specified period of time during the second quarter of 2007, therefore holders of the exchangeable senior notes may not elect to convert them during the third quarter of 2007.

The Company has irrevocably agreed to pay only cash for the accreted principal amount of the exchangeable senior notes relative to its exchange obligations, but has retained the right to satisfy the exchange obligations in excess of the accreted principal amount in cash and/or common stock. Though the Company has retained that right, FAS 128, Earnings Per Share, requires an assumption that shares will be used to pay the exchange obligations in excess of the accreted principal amount, and requires that those shares be included in the Company's calculation of weighted average common shares outstanding for diluted earnings per share computation. No shares were included in the computation at June 30, 2007 because there was no excess over the accreted principal for the period.

For the purposes of computing the diluted impact on earnings per share of the potential conversion of Series A Participating Redeemable Preferred Operating Partnership units into common shares, where the Company has the option to redeem in cash or shares as discussed in Note 14 and where the Company has stated the positive intent and ability to settle at least \$115 million of the instrument in cash (or net settle a portion of the preferred Operating Partnership units against the related outstanding note receivable), only the amount of the instrument in excess of \$115 million is considered in the calculation of shares contingently issuable for the purposes of computing diluted earnings per share as allowed by paragraph 29 of FAS 128. As of June 30, 2007 only nine of the ten properties had closed. As such, \$106,465 (the pro rata portion of the \$115 million referenced above) was excluded from the calculation.

For the three months ended June 30, 2007 and 2006, options to purchase approximately 325,934 and 1,143,380 shares of common stock, and for the six months ended June 30, 2007 and 2006, options to purchase approximately 204,315 and 1,148,173 shares of common stock, respectively, were excluded from the computation of earnings per share as their effect would have been anti-dilutive.

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

The computation of net income per share is as follows:

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
Net income	\$ 8,695	\$ 3,092	\$ 15,165	\$ 3,830
Add:				
Income allocated to minority interest - Operating Partnership	515	225	899	279
Net income for diluted computations	\$ 9,210	\$ 3,317	\$ 16,064	\$ 4,109
Weighted average common shares outstanding:				
Average number of common shares outstanding - basic	64,439,138	51,625,135	64,356,827	51,606,618
Operating Partnership units	4,012,379	3,825,787	4,012,379	3,825,787
Preferred Operating Partnership units	49,949		25,113	
Dilutive stock options, restricted stock and CCS/CCU conversions	747,379	540,166	819,995	550,681
Average number of common shares outstanding - diluted	69,248,845	55,991,088	69,214,313	55,983,086
Net income per common share				
Basic	\$ 0.13	\$ 0.06	\$ 0.24	\$ 0.07
Diluted	\$ 0.13	\$ 0.06	\$ 0.23	\$ 0.07

4. REAL ESTATE ASSETS

The components of real estate assets are summarized as follows:

	June 30, 2007	December 31, 2006
Land	\$ 419,038	\$ 361,569
Buildings and improvements	1,296,813	1,085,269
Intangible assets - tenant relationships	29,937	25,436
Intangible lease rights	5,900	3,400
	1,751,688	1,475,674
Less: accumulated depreciation and amortization	(110,568)	(93,619)
Net operating real estate assets	1,641,120	1,382,055
Real estate under development	35,906	35,336
Net real estate assets	\$ 1,677,026	\$ 1,417,391

5. PROPERTY ACQUISITIONS

The following table shows the Company's acquisition of operating properties for the six months ended June 30, 2007 and does not include purchases of raw land or improvements made to existing assets:

Property Location(s)	Number of Properties	Date of Acquisition	Total Consideration	Cash Paid	Loan Assumed	Net Liabilities / (Assets) Assumed	Value of OP Units Issued	Number of OP Units Issued	Source of Acquisition	Notes
California	1	6/26/2007	\$ 11,216	\$ 196	\$ 2,822	\$ 1	\$ 8,197	61,398	Unrelated third party	(1)
California (6) & Hawaii (2)	8	6/25/2007	126,623	11,154		1,933	113,536	847,677	Unrelated third party	(1)
Georgia	3	6/14/2007	13,693	13,594		99			Unrelated franchisee	
California	1	6/14/2007	18,703	867	14,062	(60)	3,834	218,693	Unrelated third party	(2)
Maryland	1	6/6/2007	14,942	8,128	6,834	(20)			Unrelated third party	
California	1	6/1/2007	4,020	4,036		(16)			Unrelated third party	
Florida	1	5/31/2007	8,975	8,882		93			Unrelated third party	
California	1	5/24/2007	5,585	5,575		10			Unrelated third party	
Maryland	1	4/17/2007	12,670	5,428	7,292	(50)			Unrelated third party	
Florida	1	3/27/2007	6,320	6,257		63			Unrelated franchisee	
Maryland	1	1/11/2007	14,334	14,348		(14)			Unrelated franchisee	
Tennessee	1	1/5/2007	3,684	3,672		12			Unrelated franchisee	
Arizona	1	1/2/2007	4,361	4,527		(166)			Related joint venture	
Total	22		\$ 245,126	\$ 86,664	\$ 31,010	\$ 1,885	\$ 125,567	1,127,768		

Notes:

(1) - Preferred Operating Partnership Units

(2) - Common Operating Partnership Units

6. INVESTMENTS IN REAL ESTATE VENTURES

Investments in real estate ventures consisted of the following:

	Excess Profit Participation %	Equity Ownership %	Investment balance at June 30, 2007	December 31, 2006
Extra Space West One LLC (ESW)	40%	5%	\$ 1,742	\$ 1,918
Extra Space Northern Properties Six, LLC (ESNPS)	35%	10%	1,684	1,757
PRISA Self Storage LLC (PRISA)	17%	2%	13,303	13,393
PRISA II Self Storage LLC (PRISA II)	17%	2%	10,839	10,821
PRISA III Self Storage LLC (PRISA III)	20%	5%	4,513	4,534
VRS Self Storage LLC (VRS)	20%	5%	4,584	4,547
WCOT Self Storage LLC (WCOT)	20%	5%	5,308	5,287
Storage Portfolio I, LLC (SP I)	40%	25%	18,743	19,260
Storage Portfolio Bravo II (SPB II)	45%	20%	14,956	15,264
Other minority owned properties	10-50%	10-50%	15,631	11,334
			\$ 91,303	\$ 88,115

In these joint ventures, the Company and the joint venture partner generally receive a preferred return on their invested capital. To the extent that cash/profits in excess of these preferred returns are generated through operations or capital transactions, the Company would receive a higher percentage of the excess cash/profits than its equity interest.

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

On March 1, 2007, the Company acquired a 39.5% interest in U-Storage de Mexico S.A., an existing Mexican corporation (U-Storage), which currently manages, develops, owns and operates self storage facilities in Mexico. Included in Other Minority Owned Properties is \$5,086 relating to the Company's investment in Mexico. Kenneth T. Woolley, a former Senior Vice President of the Company and son of Kenneth M. Woolley, the CEO of the Company, also acquired a 0.5% interest in U-Storage de Mexico S.A.

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

The components of equity in earnings of real estate ventures consist of the following:

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
Equity in earnings of ESW	\$ 348	\$ 341	\$ 696	\$ 681
Equity in earnings of ESNPS	41	38	87	74
Equity in earnings of PRISA	185	132	355	256
Equity in earnings of PRISA II	147	115	277	221
Equity in earnings of PRISA III	71	30	134	53
Equity in earnings of VRS	62	41	123	75
Equity in earnings of WCOT	77	40	147	73
Equity in earnings of SP I	248	301	453	601
Equity in earnings of SPB II	181	242	371	473
Equity in earnings/(losses) of other minority owned properties	(168)	(193)	(254)	(281)
	\$ 1,192	\$ 1,087	\$ 2,389	\$ 2,226

Equity in earnings of SP I and SPB II includes the amortization of the Company's excess purchase price of approximately \$22 million of these equity investments over its original basis. The excess basis is amortized over 40 years.

7. SHORT-TERM INVESTMENTS

The Company accounts for its investments in debt and equity securities according to the provisions of Statement of Financial Accounting Standards (SFAS) No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, which requires securities classified as available-for-sale to be stated at fair value. Adjustments to fair value of available-for-sale securities are recorded as a component of other comprehensive income (loss). A decline in the market value of equity securities below cost, that is deemed to be other than temporary, results in a reduction in the carrying amount to fair value. The impairment is charged to earnings and a new cost basis for the security is established. At June 30, 2007, the Company had \$90,331 in highly-liquid auction rate securities (ARS), government and corporate bonds and variable rate demand notes classified as available-for-sale securities. Although these ARS have long-term stated contractual maturities, they can be presented for redemption at auction when rates are reset which is typically every 7, 28 or 35 days. The Company had no realized or unrealized gains or losses related to these securities during the three and six months ended June 30, 2007. All income related to these investments was recorded as interest income. In accordance with the Company's investment policy, the Company only invests in ARS with high credit quality issuers and limits the amount of investment exposure to any one issuer.

8. NOTES PAYABLE

The components of notes payable are summarized as follows:

	June 30, 2007	December 31, 2006
Fixed Rate		
Mortgage and construction loans with banks bearing interest at fixed rates between 4.65% and 8.33%. The loans are collateralized by mortgages on real estate assets and the assignment of rents. Principal and interest payments are made monthly with all outstanding principal and interest due between March 1, 2008 and January 1, 2023.	\$ 811,008	\$ 743,511
Variable Rate		
Mortgage and construction loans with banks bearing floating interest rates (including loans subject to interest rate swaps) based on LIBOR. Interest rates based on LIBOR are between LIBOR plus 0.66% (5.98% and 6.01% at June 30, 2007 and December 31, 2006, respectively) and LIBOR plus 2.00% (7.32% and 7.35% at June 30, 2007 and December 31, 2006, respectively). The loans are collateralized by mortgages on real estate assets and the assignment of rents. Principal and interest payments are made monthly with all outstanding principal and interest due between October 25, 2007 and June 11, 2009.	64,722	85,073
	\$ 875,730	\$ 828,584

Real estate assets are pledged as collateral for the notes payable. The Company is subject to certain restrictive covenants relating to the outstanding notes payable. The Company was in compliance with all covenants at June 30, 2007.

In October 2004, the Company entered into a reverse interest rate swap agreement (Swap Agreement) to float \$61,770 of 4.30% fixed interest rate secured notes due in September 2009. Under this Swap Agreement, the Company will receive interest at a fixed rate of 4.30% and pay interest at a variable rate equal to LIBOR plus 0.66%. The Swap Agreement matures at the same time the notes are due. This Swap Agreement is a fair value hedge, as defined by SFAS No. 133, and the fair value of the Swap Agreement is recorded as an asset or liability, with an offsetting adjustment to the carrying value of the related note payable. Monthly variable interest payments are recognized as an increase or decrease in interest expense.

The estimated fair value of the Swap Agreement at June 30, 2007 and December 31, 2006 was reflected as an other liability of \$1,800 and \$1,925, respectively. The Company recorded additional interest expense relating to the Swap Agreement of \$264 and \$186 for the three months ended June 30, 2007 and 2006, respectively. Interest expense was increased by \$525 and reduced by \$148 for the six months ended June 30, 2007 and 2006, respectively.

9. NOTES PAYABLE TO TRUSTS

During July 2005, ESS Statutory Trust III (the Trust III), a newly formed Delaware statutory trust and a wholly-owned, unconsolidated subsidiary of the Operating Partnership, issued an aggregate of \$40.0 million of preferred securities which mature on July 31, 2035. In addition, the Trust III issued 1,238 of Trust common securities to the Operating Partnership for a purchase price of \$1.2 million. On July 27, 2005, the proceeds from the sale of the preferred and common securities of \$41.2 million were loaned in the form of a note to the Operating Partnership (Note 3). Note 3 has a fixed rate of 6.91% through July 31, 2010, and then will be payable at a variable rate equal to the three-month LIBOR plus 2.40% per annum. The interest on Note 3, payable quarterly, will be used by the Trust III to pay dividends on the trust preferred securities. The trust preferred securities may be redeemed by the Trust with no prepayment premium after July 27, 2010.

During May 2005, ESS Statutory Trust II (the Trust II), a newly formed Delaware statutory trust and a wholly-owned, unconsolidated subsidiary of the Operating Partnership, issued an aggregate of \$41.0 million of preferred securities which mature on June 30, 2035. In addition, the Trust II issued 1,269 of Trust common securities to the Operating Partnership for a purchase price of \$1.3 million. On May 24, 2005, the proceeds from the sale of the preferred and common securities of \$42.3 million were loaned in the form of a note to the Operating Partnership (Note 2). Note 2 has a fixed rate of 6.67% through June 30, 2010, and then will be payable at a variable rate equal to the three-month LIBOR plus 2.40% per annum.

The interest on Note 2, payable quarterly, will be used by the Trust II to pay dividends on the trust preferred securities. The trust preferred securities may be redeemed by the Trust with no prepayment premium after June 30, 2010.

During April 2005, ESS Statutory Trust I (the Trust), a newly formed Delaware statutory trust and a wholly-owned, unconsolidated subsidiary of the Operating Partnership issued an aggregate of \$35.0 million of trust preferred securities which mature on June 30, 2035. In addition, the Trust issued 1,083 of trust common securities to the Operating Partnership for a purchase price of \$1.1 million. On April 8, 2005, the proceeds from the sale of the trust preferred and common securities of \$36.1 million were loaned in the form of a note to the Operating Partnership (the Note). The Note has a variable rate equal to the three-month LIBOR plus 2.25% per annum. The interest on the Note, payable quarterly, will be used by the Trust to pay dividends on the trust preferred securities. The trust preferred securities may be redeemed by the Trust with no prepayment premium after June 30, 2010.

The Company follows Financial Accounting Standards Board (FASB) Interpretation No. 46R, Consolidation of Variable Interest Entities (FIN 46R), which addresses the consolidation of variable interest entities (VIEs). Under FIN 46R, Trust, Trust II and Trust III are VIEs that are not consolidated because the Company is not the primary beneficiary. A debt obligation has been recorded in the form of notes as discussed above for the proceeds, which are owed to the Trust, Trust II, and Trust III by the Company.

10. EXCHANGEABLE SENIOR NOTES

On March 27, 2007, our Operating Partnership issued \$250.0 million of its 3.625% Exchangeable Senior Notes due April 1, 2027 (the Notes). Costs incurred to issue the Notes were approximately \$5.7 million. These costs are being amortized as an adjustment to interest expense over five years, which represents the estimated term of the Notes, and are included in other assets in the condensed consolidated balance sheet as of June 30, 2007. The 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 October 1, 2007 until the maturity date of April 1, 2027. The Notes bear interest at 3.625% per annum and contain an exchange settlement feature, which provides that the Notes may, under certain circumstances, be exchangeable for cash (up to the principal amount of the Notes) and, with respect to any excess exchange value, for cash, shares of our common stock or a combination of cash and shares of our common stock at an initial exchange rate of approximately 42.5822 shares per \$1,000 principal amount of Notes at the option of the Operating Partnership.

The Operating Partnership may redeem the Notes at any time to preserve the Company's status as a REIT. In addition, on or after April 5, 2012, the Operating Partnership may redeem the 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 holders of the Notes.

The holders of the Notes have the right to require the Operating Partnership to repurchase the Notes for cash, in whole or in part, on each of April 1, 2012, April 1, 2017 and April 1, 2022, and upon the occurrence of a designated event, in each case for a repurchase price equal to 100% of the principal amount of the Notes plus accrued and unpaid interest. Certain events are considered Events of Default, as defined in the indenture governing the Notes, which may result in the accelerated maturity of the Notes.

The Company has considered whether the exchange settlement feature represents an embedded derivative within the debt instrument under the guidance of FAS 133 *Accounting for Derivative Instruments and Hedging Activities*, EITF 90-19 *Convertible Bonds with Issuer Option to Settle for Cash Upon Conversion*, and EITF 01-6 *The Meaning of Indexed to a Company's Own Stock* that would require bifurcation (i.e., separate accounting). The Company has concluded that the exchange settlement feature has satisfied the exemption in SFAS 133 because it is indexed to the Company's own stock and would otherwise be classified in stockholders equity, among other considerations. Accordingly, the Notes are presented as a single debt instrument (often referred to as Instrument C in EITF 90-19) in accordance with APB 14 *Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants* due to the inseparability of the debt and the conversion feature.

11. LINE OF CREDIT

The Company, as guarantor, and its Operating Partnership have entered into a \$100.0 million revolving line of credit, which includes a \$10.0 million swingline subfacility (the Credit Facility).

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

The Credit Facility has an interest rate of 175 basis points over LIBOR (7.07% and 7.10% at June 30, 2007 and December 31, 2006, respectively). The Operating Partnership intends to use the proceeds of the Credit Facility for general corporate purposes. As of June 30, 2007, the Credit Facility had approximately \$81 million of capacity based on the assets collateralizing the Credit Facility. No amounts were outstanding on the line of credit at June 30, 2007 or December 31, 2006. The maturity date on the line of credit is September 2007. The Credit Facility is collateralized by mortgages on certain real estate assets.

12. RELATED PARTY AND AFFILIATED REAL ESTATE JOINT VENTURE TRANSACTIONS

The Company provides management and development services for certain joint ventures, franchise, third party and other related party properties. Management agreements generally provide for management fees of 6% of cash collected from properties for the management of operations at the self-storage facilities. The Company earns development fees of 4%-6% of budgeted costs on developmental projects.

Management fee revenue for related party and affiliated real estate joint ventures is summarized as follows:

Entity	Type	Three months ended June 30,		Six months ended June 30,	
		2007	2006	2007	2006
ESW	Affiliated real estate joint ventures	\$ 109	\$ 103	\$ 218	\$ 204
ESNPS	Affiliated real estate joint ventures	109	104	216	206
PRISA	Affiliated real estate joint ventures	1,294	1,259	2,595	2,491
PRISA II	Affiliated real estate joint ventures	1,048	1,018	2,090	2,018
PRISA III	Affiliated real estate joint ventures	474	456	942	908
VRS	Affiliated real estate joint ventures	283	280	568	553
WCOT	Affiliated real estate joint ventures	387	364	768	723
SP I	Affiliated real estate joint ventures	316	303	626	601
SPB II	Affiliated real estate joint ventures	254	261	516	517
Extra Space Development (ESD	Related party	188	110	355	206
Various	Franchisees, third parties and other	681	923	1,457	1,913
		\$ 5,143	\$ 5,181	\$ 10,351	\$ 10,340

Development fee revenue for related party and affiliated real estate joint ventures is summarized as follows:

Type	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
Affiliated real estate joint ventures	\$ 182	\$ 122	\$ 237	\$ 147
Related party		53		78
	\$ 182	\$ 175	\$ 237	\$ 225

Effective January 1, 2004, the Company entered into a license agreement with Centershift, a related party software provider, to secure a perpetual right for continued use of STORE (the site management software used at all sites operated by the Company) in all aspects of the Company's property acquisition, development, redevelopment and operational activities. The Company paid Centershift \$266 and \$190 for the three months ended June 30, 2007 and 2006, respectively, and \$455 and \$368 for the six months ended June 30, 2007 and 2006, respectively, relating to the purchase of software and to license agreements.

Related party and affiliated real estate joint ventures balances are summarized as follows:

	June 30, 2007	December 31, 2006
Receivables:		
Development fees	\$ 2,869	\$ 2,633
Other receivables from properties	5,452	13,247
	\$ 8,321	\$ 15,880

Other receivables from properties consist of amounts due for management fees and expenses paid by the Company on behalf of the managed properties. The Company believes that all of these related party and affiliated joint venture receivables are fully collectible. The Company did not have any payables to related parties at June 30, 2007 or December 31, 2006.

13. MINORITY INTEREST IN OPERATING PARTNERSHIP

The Company's interest in its properties is held through the Operating Partnership. ESS Holding Business Trust I, a wholly owned subsidiary of the Company, is the sole general partner of the Operating Partnership. The Company, through ESS Holding Business Trust II, a wholly owned subsidiary of the Company, is also a limited partner of the Operating Partnership. Between its general partner and limited partner interests, the Company held a 94.17% majority ownership interest therein as of June 30, 2007. The remaining ownership interests in the Operating Partnership of 5.83% are held by certain former owners of assets acquired by the Operating Partnership, which include a director and officers of the Company.

The minority interest in the Operating Partnership represents Operating Partnership units that are not owned by the Company. In conjunction with the formation of the Company and as a result of subsequent acquisitions, certain persons and entities contributing interests in properties to the Operating Partnership received limited partnership units in the form of either Operating Partnership units or Contingent Conversion Units. Limited partners who received Operating Partnership units in the formation transactions or in exchange for contributions for interests in properties have the right to require the Operating Partnership to redeem part or all of their Operating Partnership units for cash based upon the fair market value of an equivalent number of shares of the Company's common stock at the time of the redemption. Alternatively, the Company may, at its option, elect to acquire those Operating Partnership units in exchange for shares of its common stock on a one-for-one basis, subject to anti-dilution adjustments provided in the Operating Partnership agreement.

As of June 30, 2007, the Operating Partnership had 4,012,379 and 174,307 Operating Partnership units and CCUs outstanding, respectively.

Unlike the Operating Partnership units, CCUs do not carry any voting rights. Upon the achievement of certain performance thresholds relating to 14 early-stage lease-up properties, all or a portion of the CCUs will be automatically converted into Operating Partnership units. Initially, each CCU will be convertible on a one-for-one basis into Operating Partnership units, subject to customary anti-dilution adjustments. Beginning with the quarter ended March 31, 2006, and ending with the quarter ending December 31, 2008, the Company will calculate the net operating income from the 14 wholly-owned early-stage lease-up properties over the 12-month period ending in such quarter. Within 35 days following the end of each quarter referred to above, some or all of the CCUs will be converted so that the total percentage (not to exceed 100%) of CCUs issued in connection with the formation transactions that have been converted to Operating Partnership units will be equal to the percentage determined by dividing the net operating income for such period in excess of \$5.1 million by \$4.6 million. If any CCU remains unconverted through the calculation made in respect of the 12-month period ending December 31, 2008, such outstanding CCUs will be cancelled.

While any CCUs remain outstanding, a majority of the Company's independent directors must review and approve the net operating income calculation for each measurement period and also must approve any sales of any of the 14 wholly-owned early-stage lease-up properties.

As of June 30, 2007, there were 25,739 CCUs converted to Operating Partnership units. Based on the performance of the properties as of June 30, 2007, an additional 20,198 CCUs became eligible for conversion. The board of directors approved the conversion of these CCUs on August 1, 2007 as per the Company's charter, and the units were issued on August 3, 2007.

14. PREFERRED OPERATING PARTNERSHIP UNITS

On June 15, 2007, the Operating Partnership entered into a Contribution Agreement with various limited partnerships affiliated with AAAA Rent-A-Space to acquire ten self-storage facilities (the "Properties") in exchange for the issuance of newly designated Series A Participating Redeemable Preferred Units ("Preferred OP Units") of the Operating Partnership. The self-storage facilities are located in California and Hawaii.

On June 25 and 26, 2007, nine of the ten properties were contributed to the Operating Partnership in exchange for consideration totaling \$137.8 million. Preferred OP units totaling 909,075, with a value of \$121.7 million, were issued along with the assumption of approximately \$14.2 million of third-party debt, of which \$11,381 was paid off at close. The final property was purchased by the Company on August 1, 2007.

On June 25, 2007, the Company loaned the holders of the Preferred OP Units \$100.0 million. The receivable bears interest at 4.85%, and is due September 1, 2017. The loan is secured by the borrower's Preferred OP Units. In addition, any conversion of the Preferred OP Units prior to the maturity date requires repayment of the loan as of the date of the Preferred OP Unit

redemption. Preferred OP Units are shown on the balance sheet net of the \$100.0 million loan under the guidance in EITF No. 85-1, *Classifying Notes Receivable for Capital* because the borrower under the loan receivable is also the holder of the Preferred OP Units.

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

Per the Partnership Agreement, Preferred OP Units in the amount of \$115.0 million bear a fixed priority return of 5% and have a fixed liquidation value of \$115.0 million. The remaining balance will participate in distributions with and have a liquidation value equal to that of the common Operating Partnership units. Included in the June 30, 2007 financials statements was the pro rata amount of \$106,464 related to the \$115.0 million due to the Company not closing on the final property until August 1, 2007. The Preferred OP Units will be redeemable at the option of the holder on or after September 1, 2008, which redemption obligation may be satisfied, at the Company's option, in cash or shares of its common stock.

In accordance with SFAS 133 *Accounting for Derivative Instruments and Hedging Activities*, SFAS 150 *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*, EITF 00-19 *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock*, EITF Topic D-109, *Determining the Nature of a Host Contract Related to a Hybrid Financial Instrument Issued in the Form of a Share under FASB Statement No. 133*, and Accounting Series Release (ASR) No. 268, *Presentation in Financial Statements of Redeemable Preferred Stocks*, the Preferred OP Units were classified as a hybrid instrument such that the value of the units associated with the fixed return are classified in mezzanine after total liabilities on the balance sheet and before stockholders' equity. The remaining balance that participates in distributions equal to that of common stock has been identified as an embedded derivative and has been classified as a liability on the balance sheet and is marked to fair value on a quarterly basis with any adjustment being recorded to the income statement. As of June 30, 2007, the carrying value of the obligation associated with the Preferred OP Units approximated fair value.

The following table summarizes the components of the transaction:

\$ 121,733	Total amount of Preferred OP Units issued at June 30, 2007
(15,268)	Derivative instrument associated with the Preferred OP Units presented as a liability
106,465	Value of Preferred OP units considered as mezzanine equity
(100,000)	Less note receivable to Preferred OP unit holder
\$ 6,465	Net value of Preferred OP units considered as mezzanine equity

15. STOCKHOLDERS' EQUITY

The Company's charter provides that it can issue up to 200,000,000 shares of common stock, \$0.01 par value per share, 4,100,000 Contingent Conversion Shares, \$0.01 par value per share, and 50,000,000 shares of preferred stock, \$0.01 par value per share. As of June 30, 2007, 64,833,425 shares of common stock were issued and outstanding, 3,388,493 CCSs were issued and outstanding and no shares of preferred stock were issued and outstanding. All stockholders of the Company's common stock are entitled to receive dividends and to one vote on all matters submitted to a vote of stockholders.

Unlike the Company's shares of common stock, CCSs do not carry any voting rights. Upon the achievement of certain performance thresholds relating to 14 early-stage lease-up properties, all or a portion of the CCSs will be automatically converted into shares of the Company's common stock. Initially, each CCS will be convertible on a one-for-one basis into shares of common stock, subject to customary anti-dilution adjustments. Beginning with the quarter ended March 31, 2006, and ending with the quarter ending December 31, 2008, the Company will calculate the net operating income from the 14 wholly-owned early-stage lease-up properties over the 12-month period ending in such quarter. Within 35 days following the end of each quarter referred to above, some or all of the CCSs will be converted so that the total percentage (not to exceed 100%) of CCSs issued in connection with the formation transactions that have been converted to common stock will be equal to the percentage determined by dividing the net operating income for such period in excess of \$5.1 million by \$4.6 million. If any CCS remains unconverted through the calculation made in respect of the 12-month period ending December 31, 2008, such outstanding CCSs will be cancelled and restored to the status of authorized but unissued shares of common stock.

While any CCSs remain outstanding, a majority of the Company's independent directors must review and approve the net

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

operating income calculation for each measurement period and also must approve any sales of any of the 14 wholly-owned early-stage lease-up properties.

As of June 30, 2007, there were 500,350 CCSs converted to common stock. Based on the performance of the properties as of June 30, 2007, an additional 392,648 CCSs became eligible for conversion. The board of directors approved the conversion of these CCSs on August 1, 2007 as per the Company's charter, and the shares were issued on August 3, 2007.

16. STOCK-BASED COMPENSATION

Options

The Company has the following two stock option plans under which shares were available for grant at June 30, 2007: 1) the 2004 Long-Term Incentive Compensation Plan, and 2) the 2004 Non-Employee Directors' Share Plan. Under the terms of the plans, the exercise price of an option is the fair value of the stock on the date of grant. Each option becomes exercisable after the period or periods specified in the award agreement, which generally do not exceed 10 years from the date of grant. Options are exercisable at such times and subject to such terms as determined by the Compensation, Nominating and Governance Committee; options may not be exercised if such exercise would cause a violation of the ownership limit in the Company's charter. Unless otherwise determined by the Compensation, Nominating and Governance Committee at the time of grant, stock options vest ratably over a four-year period beginning on the date of grant.

The following assumptions were used to estimate the fair value of options granted during the six months ended June 30, 2007 and 2006 using the Black-Scholes option-pricing model:

	Six Months Ended June 30,			
	2007		2006	
Expected volatility	23	%	22	%
Dividend yield	5.8	%	6.4	%
Risk-free interest rate	4.9	%	4.7	%
Average expected term (years)	5		5	

The Black-Scholes model incorporates assumptions to value stock-based awards. The risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant for the estimated life of the option. The Company uses actual historical data to calculate the expected price volatility and average expected term. The forfeiture rate, which is estimated at a weighted average of 18.93% of unvested options outstanding as of June 30, 2007, is adjusted periodically based on the extent to which actual forfeitures differ, or are expected to differ, from the previous estimate.

The following table summarizes the Company's activities with respect to its stock option plans:

Options	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value as of June 30, 2007
Outstanding at December 31, 2006	2,564,563	\$ 13.92		
Granted	321,000	19.61		
Exercised	(76,048)	13.63		
Forfeited	(104,251)	14.32		
Outstanding at June 30, 2007	2,705,264	\$ 14.53	7.85	\$ 6,256,459
Vested and Expected to Vest	1,973,200	\$ 14.34	7.77	\$ 4,837,556
Ending Exercisable	836,397	\$ 13.54	7.47	\$ 2,475,896

The aggregate intrinsic value in the table above represents the total value (the difference between the Company's closing stock price on the last trading day of the second quarter of 2007 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on June 30, 2007. The amount of aggregate intrinsic value will change based on the fair market value of the Company's stock.

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

The Company recorded compensation expense relating to outstanding options of \$196 and \$250 for the three months ended June 30, 2007 and 2006, respectively, and \$419 and \$450 for the six months ended June 30, 2007 and 2006, respectively. The Company received cash from the exercise of options of \$305 and \$36 for the three months ended June 30, 2007 and 2006, respectively, and \$1,033 and \$127 for the six months ended June 30, 2007 and 2006, respectively. At June 30, 2007, there was \$1,422 of total unrecognized compensation expense related to non-vested stock options under the Company's 2004 Long-Term Incentive Compensation Plan. That cost is expected to be recognized over a weighted-average period of 2.01 years. The valuation model applied in this calculation utilizes subjective assumptions that could potentially change over time, including the expected forfeiture rate. Therefore, the amount of unrecognized compensation expense at June 30, 2007, noted above does not necessarily represent the expense that will ultimately be realized by the Company in the Statement of Operations.

Common Stock Granted to Employees

Common stock is granted to certain employees without monetary consideration under the Company's 2004 Long-Term Incentive Compensation Plan. At the date of grant, the recipient has all rights of a stockholder including the right to vote and receive dividends subject to restrictions on transfer and forfeiture provisions. The forfeiture and transfer restrictions on the shares lapse over a two to four year period beginning on the date of grant.

The Company recorded compensation expense relating to outstanding shares of common stock granted to employees of \$242 and \$197 for the three months ended June 30, 2007 and 2006, respectively, and \$456 and \$383 for the six months ended June 30, 2007 and 2006, respectively.

The fair value of common stock awards is determined based on the closing trading price of the Company's common stock on the grant date. A summary of the Company's employee share grant activity is as follows:

Restricted Stock Grants	Shares	Weighted-Average Grant-Date Fair Value
Unreleased at December 31, 2006	156,300	\$ 15.94
Granted	90,529	19.25
Released	(27,500)	15.72
Cancelled	(600)	18.24
Unreleased at June 30, 2007	218,729	\$ 17.35

17. SEGMENT INFORMATION

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

	June 30, 2007	December 31, 2006
Balance Sheet		
Investment in real estate ventures		
Rental operations	\$ 91,303	\$ 88,115
Total assets		
Property management, acquisition and development	\$ 373,759	\$ 223,402
Rental operations	1,610,180	1,446,423
	\$ 1,983,939	\$ 1,669,825

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

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
Statement of Operations				
Total revenues				
Property management, acquisition and development	\$ 8,158	\$ 6,511	\$ 15,703	\$ 12,706
Rental operations	48,392	42,020	94,623	81,195
	\$ 56,550	\$ 48,531	\$ 110,326	\$ 93,901
Operating expenses, including depreciation and amortization				
Property management, acquisition and development	\$ 10,684	\$ 9,561	\$ 21,409	\$ 19,940
Rental operations	26,135	24,104	51,565	47,939
	\$ 36,819	\$ 33,665	\$ 72,974	\$ 67,879
Income (loss) before interest, minority interests and equity in earnings of real estate ventures				
Property management, acquisition and development	\$ (2,526)	\$ (3,050)	\$ (5,706)	\$ (7,234)
Rental operations	22,257	17,916	43,058	33,256
	\$ 19,731	\$ 14,866	\$ 37,352	\$ 26,022
Interest expense				
Property management, acquisition and development	\$ (401)	\$ (186)	\$ (564)	\$ (386)
Rental operations	(15,036)	(12,598)	(28,269)	(24,383)
	\$ (15,437)	\$ (12,784)	\$ (28,833)	\$ (24,769)
Interest income				
Property management, acquisition and development	\$ 3,668	\$ 148	\$ 5,116	\$ 630
Minority interests - Operating Partnership and other				
Property management, acquisition and development	\$ (459)	\$ (225)	\$ (859)	\$ (279)
Equity in earnings of real estate ventures				
Rental operations	\$ 1,192	\$ 1,087	\$ 2,389	\$ 2,226
Net income (loss)				
Property management, acquisition and development	\$ 282	\$ (3,313)	\$ (2,013)	\$ (7,269)
Rental operations	8,413	6,405	17,178	11,099
	\$ 8,695	\$ 3,092	\$ 15,165	\$ 3,830
Depreciation and amortization expense				
Property management, acquisition and development	\$ 340	\$ 201	\$ 602	\$ 384
Rental operations	8,783	8,856	17,317	17,949
	\$ 9,123	\$ 9,057	\$ 17,919	\$ 18,333
Statement of Cash Flows				
Acquisition of real estate assets				
Property management, acquisition and development			\$ (98,148)	\$ (87,964)
Development and construction of real estate assets				
Property management, acquisition and development			\$ (19,381)	\$ (15,118)

18. COMMITMENTS AND CONTINGENCIES

The Company has guaranteed two construction loans for unconsolidated partnerships that own development properties in Baltimore, Maryland and Chicago, Illinois. These properties are owned by joint ventures in which the Company has 10% equity interests. These guarantees were entered into in November 2004 and July 2005, respectively. At June 30, 2007, the total amount of guaranteed mortgage debt relating to these joint ventures was \$13,095. These mortgage loans mature December 1, 2007 and July 28, 2008, respectively. If the joint ventures default on the

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

loans, the Company may be forced to repay the loans. Repossessing and/or selling the self-storage facilities and land that collateralize the loans could provide funds sufficient to reimburse the Company. The estimated fair market value of the encumbered assets at June 30, 2007, was \$16,281. The Company has recorded no liability in relation to this guarantee as of June 30, 2007. The fair value of the guarantee is not material. To date, the joint ventures have not defaulted on their mortgage debt. The Company believes the risk of having to perform on the guarantee is remote.

The Company has been involved in routine litigation arising in the ordinary course of business. As of June 30, 2007, the Company was not involved in any material litigation nor, to its knowledge, was any material litigation threatened against it, or its properties.

19. INCOME TAXES

The Company adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48), an interpretation of FASB Statement No. 109 (SFAS 109) on January 1, 2007. As a result of the implementation of FIN 48, the Company recognized no material adjustment in the liability for unrecognized income tax benefits. At the adoption date of January 1, 2007, there were no material unrecognized tax benefits. At June 30, 2007, there were no material unrecognized tax benefits.

Interest and penalties related to uncertain tax positions will be recognized in income tax expense, when incurred. As of June 30, 2007, the Company had no interest and penalties related to uncertain tax positions.

The tax years 2003-2006 remain open to examination by the major taxing jurisdictions to which the Company is subject.

20. SUBSEQUENT EVENTS

On August 1, 2007, one property was contributed to the Operating Partnership in exchange for consideration totaling \$14.6 million. Preferred OP Units of 80,905 with a value of \$9.8 million were issued along with cash of approximately \$4.8 million.

Extra Space Storage Inc.

Management's Discussion and Analysis

Amounts in thousands, except property and per share data

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

CAUTIONARY LANGUAGE

The following discussion and analysis should be read in conjunction with our *Unaudited Condensed Consolidated Financial Statements* and the *Notes to Unaudited Condensed Consolidated Financial Statements* contained 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, 2006. The Company makes statements in this section that are forward-looking statements within the meaning of the federal securities laws. For a complete discussion of forward-looking statements, see the section in this Form 10-Q entitled *Statement on Forward-Looking Information*. Amounts are in thousands (except per share data and unless otherwise stated).

CRITICAL ACCOUNTING POLICIES

Our discussion and analysis of our financial condition and results of operations are based on our unaudited Condensed Consolidated Financial Statements contained elsewhere in this report, which have been prepared in accordance with U.S. generally accepted accounting principles (GAAP). Our notes to the unaudited Condensed Consolidated Financial Statements contained elsewhere in this report and the Audited Consolidated Financial Statements contained in our Form 10-K for the year ended December 31, 2006 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 which we have used are appropriate and correct based on information available at the time that they were made. These estimates, judgments and assumptions can affect our reported assets and liabilities as of the date of the financial statements, as well as the reported revenue and expense 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.

RECENT ACCOUNTING PRONOUNCEMENTS

Emerging Issues Task Force (EITF) Topic D-109, *Determining the Nature of a Host Contract Related to a Hybrid Financial Instrument Issued in the Form of a Share under FASB Statement No. 133* (Topic D-109), discussed at the March 15, 2007 EITF meeting, is effective at the beginning of the first fiscal quarter beginning after June 15, 2007 (even if that period is other than the first fiscal quarter of the registrant's fiscal year). Topic D-109 provides the SEC staff's view as to how one must evaluate whether a preferred stock host contract is a debt host or an equity host. It states that the determination of the nature of the host contract for a hybrid financial instrument (that is, whether the nature of the host contract is more akin to debt or to equity) issued in the form of a share should be based on a consideration of economic characteristics and risks. The SEC staff believes that the consideration of the economic characteristics and risks of the host contract should be based on all the stated and implied substantive terms and features of the hybrid financial instrument. This may represent a change from the way these instruments were analyzed in the past.

We have elected to early adopt Topic D-109 which specifically relates to the AAAA Rent-A-Space acquisition that was completed during the quarter ended June 30, 2007.

OVERVIEW

We are a fully integrated, self-administered and self-managed real estate investment trust formed to continue the business commenced in 1977 by our predecessor company to own, operate, manage, acquire and develop self-storage properties. We derive a majority of our revenues from rents received from tenants under existing leases at each of our self-storage properties. Additional revenue is derived from management and franchise fees from our joint venture and managed properties. We operate in competitive markets where consumers have multiple self-storage properties from which to choose. Competition has and will continue to impact our results. We experience minor seasonal fluctuations in occupancy levels, with occupancy levels higher in the summer months due to increased rental activity.

Our operating results depend materially on our ability to lease available self-storage space and on the ability of our tenants to make required rental payments. We believe we are able to respond quickly and effectively to changes in local, regional and national economic conditions by centrally adjusting rental rates through the combination of our revenue management team and our industry-leading technology systems.

We continue to evaluate a range of growth initiatives and opportunities including the following:

- *Maximize the performance of properties through strategic, efficient and proactive management.* We plan to pursue revenue generating and expense minimizing opportunities in our operations. Our revenue management team will seek to maximize revenue by responding to changing market conditions through our technology system's ability to provide real-time, interactive rental rate and discount management. Our size and scale give us a greater ability than

the majority of our competitors to implement national, regional and local marketing programs, which we believe will attract more customers to our stores at a lower net cost.

- *Focus on the acquisition of self-storage properties from strategic partners and third parties.* Our acquisitions team will continue to pursue the acquisition of single properties and multi-property portfolios that we believe can provide stockholder value. Our July 2005 acquisition of Storage USA has bolstered our reputation as a reliable, ethical buyer, which we believe enhances our ability to negotiate and close acquisitions. In addition, our status as an UPREIT enables flexibility when structuring deals.
- *Develop new self-storage properties.* We have several joint venture and wholly-owned development properties and will continue to develop new self-storage properties in our core markets. Our development pipeline for the remainder of 2007 through 2008 includes 16 projects. The majority of the projects will be developed on a wholly-owned basis by the Company. The construction of many of these properties has already begun.
- *Expand the Company's management business.* We see the management business as a future acquisition pipeline and expect to pursue strategic relationships with owners that should strengthen our acquisition pipeline through agreements which give us first right of refusal to purchase the managed property in the event of a potential sale. Twelve of the Company's 2006 and seven of the Company's 2007 acquisitions have come from this channel.

PROPERTIES

As of June 30, 2007, we owned or had ownership interests in 585 operating self-storage properties located in 33 states and Washington, D.C. Of these properties, 242 are wholly-owned and consolidated, one is held in joint venture and consolidated and 342 are held in joint ventures accounted for using the equity method. In addition, we managed 59 properties for franchisees or third parties bringing the total numbers of properties which we own and/or manage to 644. We receive a management fee equal to approximately 6% of gross revenues to manage the joint venture, third party and franchise sites. As of June 30, 2007, we owned or had ownership interests in approximately 42 million square feet of space and had greater than 300,000 customers.

Approximately 70% of our properties are clustered around the larger population centers, such as Atlanta, Baltimore/Washington, D.C., Boston, Chicago, Dallas, Las Vegas, Los Angeles, Miami, New York City, Orlando, Philadelphia, Phoenix, St. Petersburg/Tampa and San Francisco. These markets contain above-average population and income demographics for new self-storage properties. The clustering of assets around these population centers enables us to reduce our operating costs through economies of scale. The Storage USA acquisition has given us an increased scale in many core markets as well as a foothold in many markets where we had no previous presence.

We consider a property to be in the lease-up stage after it has been issued a certificate of occupancy, but before it has achieved stabilization. We consider a property to be stabilized once it has achieved either an 80% occupancy rate or has been open for three years. Although leases are short-term in duration, the typical tenant tends to remain at our properties for an extended period of time. For properties that were stabilized as of June 30, 2007, the median length of stay was approximately eleven months.

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

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

The following table sets forth additional information regarding the occupancy of our stabilized properties on a state-by-state basis as of June 30, 2007 and 2006. The information as of June 30, 2006 is on a pro forma basis as though all the properties owned at June 30, 2007 were under the Company's control as of June 30, 2006.

Stabilized Property Data Based on Location

Location	Number of Properties	Company Number of Units as of June 30, 2007(1)	Pro forma Number of Units as of June 30, 2006	Company Net Rentable Square Feet as of June 30, 2007(2)	Pro forma Net Rentable Square Feet as of June 30, 2006	Company Square Foot Occupancy % June 30, 2007	Pro forma Square Foot Occupancy % June 30, 2006	
Wholly-owned properties								
Arizona	4	2,260	2,254	280,180	276,640	93.9	% 97.8	%
California	40	31,758	31,744	3,014,121	3,011,778	84.4	% 85.7	%
Colorado	5	2,399	2,394	301,691	293,591	91.3	% 91.6	%
Connecticut	1	745	745	62,505	62,430	84.5	% 72.7	%
Florida	27	17,729	17,683	1,880,443	1,878,402	86.2	% 91.8	%
Georgia	12	6,448	6,553	835,528	828,648	88.0	% 87.2	%
Hawaii	2	2,890	2,860	153,351	154,234	81.2	% 83.6	%
Illinois	4	2,674	2,691	266,454	265,487	87.8	% 83.2	%
Kansas	1	505	503	49,940	49,955	90.4	% 93.4	%
Kentucky	3	1,586	1,579	194,351	194,290	91.5	% 88.6	%
Louisiana	2	1,407	1,410	147,490	147,490	93.2	% 95.5	%
Maryland	8	6,746	6,684	731,002	703,522	85.5	% 85.0	%
Massachusetts	24	13,519	13,440	1,432,541	1,433,441	86.0	% 84.0	%
Michigan	2	1,041	1,043	134,402	135,312	90.6	% 84.8	%
Missouri	3	1,349	1,349	168,907	169,187	87.1	% 85.2	%
Nevada	2	1,256	1,242	132,465	131,135	84.3	% 86.6	%
New Hampshire	2	1,006	1,006	125,609	125,309	81.9	% 82.5	%
New Jersey	21	17,103	17,127	1,670,303	1,672,472	86.7	% 86.6	%
New York	7	6,957	6,965	455,779	456,119	82.1	% 82.4	%
Ohio	4	2,040	2,048	275,401	276,355	87.8	% 86.2	%
Oregon	1	764	767	103,450	103,610	95.7	% 94.1	%
Pennsylvania	8	6,133	6,128	640,568	637,294	86.9	% 81.8	%
Rhode Island	1	731	730	75,241	75,816	85.7	% 84.0	%
South Carolina	4	2,067	2,068	245,734	245,684	92.1	% 94.7	%
Tennessee	6	3,535	3,533	477,547	469,922	87.3	% 91.4	%
Texas	19	11,881	11,956	1,335,850	1,323,521	91.1	% 88.2	%
Utah	3	1,535	1,524	210,490	209,965	96.6	% 92.8	%
Virginia	4	2,890	2,889	272,825	273,038	88.0	% 86.3	%
Washington	3	2,031	2,030	244,865	244,595	98.3	% 96.3	%
Total Wholly-Owned Stabilized	223	152,985	152,945	15,919,033	15,849,242	87.2	% 87.3	%

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

Location	Number of Properties	Company Number of Units as of June 30, 2007(1)	Pro forma Number of Units as of June 30, 2006	Company Net Rentable Square Feet as of June 30, 2007(2)	Pro forma Net Rentable Square Feet as of June 30, 2006	Company Square Foot Occupancy % June 30, 2007	Pro forma Square Foot Occupancy % June 30, 2006	
Joint-venture properties								
Alabama	4	2,300	2,324	282,018	281,628	88.7	% 86.5	%
Arizona	11	6,901	6,888	751,141	752,076	92.0	% 94.2	%
California	72	51,822	51,931	5,315,289	5,316,072	90.2	% 89.5	%
Colorado	3	1,906	1,905	216,038	215,813	89.4	% 86.0	%
Connecticut	8	5,979	5,985	690,389	690,434	78.3	% 77.1	%
Delaware	1	589	589	71,655	71,655	94.3	% 85.5	%
Florida	24	20,344	20,355	2,080,172	2,079,353	85.7	% 88.7	%
Georgia	3	1,891	1,916	246,406	251,530	79.4	% 82.9	%
Illinois	6	4,033	4,031	433,562	436,977	82.8	% 77.3	%
Indiana	9	3,740	3,733	468,753	468,563	90.3	% 90.2	%
Kansas	3	1,217	1,210	164,225	163,950	87.9	% 85.4	%
Kentucky	4	2,282	2,270	268,509	268,289	88.9	% 84.6	%
Maryland	14	10,927	10,916	1,077,412	1,076,827	88.4	% 85.1	%
Massachusetts	16	8,500	8,556	972,499	975,597	83.9	% 81.2	%
Michigan	10	5,968	5,959	785,447	786,252	87.8	% 79.3	%
Missouri	5	2,771	2,774	324,665	325,615	85.9	% 87.6	%
Nevada	7	4,630	4,632	620,549	621,772	88.5	% 92.1	%
New Hampshire	3	1,326	1,330	138,554	138,964	87.3	% 85.5	%
New Jersey	20	15,148	15,134	1,595,238	1,588,181	81.6	% 87.7	%
New Mexico	9	4,709	4,727	526,194	528,864	86.0	% 87.1	%
New York	22	24,098	24,220	1,803,896	1,806,109	86.0	% 83.7	%
Ohio	11	5,027	5,041	751,107	753,177	87.4	% 81.5	%
Oregon	2	1,291	1,286	137,140	137,140	91.2	% 95.3	%
Pennsylvania	9	6,474	6,477	687,618	687,370	87.3	% 85.2	%
Rhode Island	1	611	611	73,905	74,005	75.8	% 68.3	%
Tennessee	22	11,828	11,851	1,547,503	1,550,417	88.8	% 87.8	%
Texas	18	11,837	11,862	1,519,316	1,525,237	81.4	% 80.7	%
Utah	1	519	524	59,500	59,700	97.2	% 93.5	%
Virginia	15	10,393	10,359	1,106,716	1,106,770	87.8	% 87.1	%
Washington	1	551	551	62,730	62,730	94.9	% 89.8	%
Washington, DC	1	1,536	1,536	102,003	101,990	94.9	% 86.2	%
Total Stabilized Joint-Ventures	335	231,148	231,483	24,880,149	24,903,057	86.9	% 86.3	%
Managed properties								
California	5	3,273	3,271	401,655	398,455	77.9	% 80.9	%
Colorado	1	513	516	56,240	56,240	91.3	% 90.2	%
Florida	1	570	572	56,485	57,125	90.5	% 96.4	%
Georgia	7	4,530	4,559	485,472	486,372	87.8	% 86.3	%
Maryland	3	3,124	3,093	256,511	255,698	82.9	% 80.0	%
Nevada	1	436	442	61,235	61,510	80.0	% 79.5	%
New Jersey	2	1,096	1,089	131,472	131,642	93.3	% 89.4	%
New Mexico	2	1,576	1,584	171,555	171,355	88.0	% 93.3	%
Pennsylvania	2	888	888	131,130	131,330	95.0	% 83.9	%
Tennessee	2	1,147	1,133	135,410	130,286	88.5	% 92.2	%
Texas	1	371	371	46,955	46,955	99.4	% 98.7	%
Utah	2	1,431	1,433	136,412	146,587	85.6	% 75.8	%
Washington, DC	2	1,255	1,256	111,759	111,809	82.5	% 82.8	%
Total Stabilized Managed Properties	31	20,210	20,207	2,182,291	2,185,364	86.0	% 85.1	%
Total Stabilized Properties	589	404,343	404,635	42,981,473	42,937,663	87.0	% 86.6	%

(1) Represents unit count as of June 30, 2007, which may differ from June 30, 2006 unit count due to unit conversions or expansions.

(2) Represents net rentable square feet as of June 30, 2007, which may differ from June 30, 2006 net rentable square feet due to unit conversions or expansions.

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

The following table sets forth additional information regarding the occupancy of our lease-up properties on a state-by-state basis as of June 30, 2007 and 2006. The information as of June 30, 2006 is on a pro forma basis as though all the properties owned at June 30, 2007 were under our control as of June 30, 2006.

Lease-up Property Data Based on Location

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

Location	Number of Properties	Company Number of Units as of June 30, 2007(1)	Pro forma Number of Units as of June 30, 2006	Company Net Rentable Square Feet as of June 30, 2007(2)	Pro forma Net Rentable Square Feet as of June 30, 2006	Company Square Foot Occupancy % June 30, 2007	Pro forma Square Foot Occupancy % June 30, 2006
Wholly-owned properties							
Arizona	1	587	599	67,375	67,375	77.3	% 32.5
California	5	3,653	2,798	433,850	330,280	56.9	% 55.8
Colorado	1	359	368	58,928	60,441	76.6	% 80.6
Connecticut	1	612	614	60,760	60,760	75.6	% 65.7
Florida	2	1,257	973	157,005	133,880	71.8	% 75.7
Illinois	1	591	588	75,800	75,820	76.4	% 66.5
Massachusetts	4	2,896	1,927	285,927	195,608	63.8	% 68.0
New Jersey	2	1,744	1,678	163,185	149,070	79.1	% 80.2
Pennsylvania	1	424	425	47,060	47,410	79.6	% 59.6
Washington	1	501	529	61,250	61,250	98.9	% 80.2
Total Wholly-Owned Lease-up	19	12,624	10,499	1,411,140	1,181,894	68.8	% 65.7
Joint-venture properties							
California	1	703		79,233		31.4	% 0.0
Illinois	1	955	957	74,153	75,399	43.1	% 0.0
Maryland	1	948	957	73,666	73,649	51.1	% 12.3
New Jersey	2	1,195	560	119,735	62,400	54.6	% 74.2
New Mexico	1	491	530	77,674	58,992	85.1	% 91.3
Pennsylvania	1	754	774	76,496	76,773	96.5	% 80.0
Virginia	1	878	878	84,383	84,383	76.6	% 58.4
Total Lease-up Joint-Ventures	8	5,924	4,656	585,340	431,596	62.2	% 50.9
Managed properties							
California	8	5,433	4,792	552,315	461,095	72.9	% 58.7
Connecticut	1	683	687	54,840	54,380	94.9	% 70.1
Florida	3	2,226	1,297	224,832	112,286	46.3	% 60.9
Georgia	2	1,007	1,114	115,215	114,780	72.2	% 58.1
Illinois	2	1,561	1,573	190,329	192,949	67.6	% 51.9
Indiana	1	587	588	68,890	69,040	72.9	% 54.5
Maryland	1	727	728	67,810	67,560	79.2	% 73.4
Massachusetts	4	3,851	3,870	338,894	341,359	64.9	% 45.8
New Jersey	1	863		78,190		20.2	% 0.0
New York	1	1,578	1,579	116,235	116,530	78.9	% 65.3
Rhode Island	1	501	506	55,670	56,095	38.9	% 16.0
Texas	2	1,167	1,172	125,505	124,445	88.7	% 73.3
Virginia	1	687	676	74,840	74,900	87.1	% 78.2
Total Lease-up Managed	28	20,871	18,582	2,063,565	1,785,419	67.8	% 57.3
Total Lease-up Properties	55	39,419	33,737	4,060,045	3,398,909	67.4	% 59.4

(1) Represents unit count as of June 30, 2007, which may differ from June 30, 2006 unit count due to unit conversions or expansions.

(2) Represents net rentable square feet as of June 30, 2007, which may differ from June 30, 2006 net rentable square feet due to unit conversions or expansions.

RESULTS OF OPERATIONS

Comparison of the three and six months ended June 30, 2007 and 2006

Overview

Results for the three and six months ended June 30, 2007 include the operations of 585 properties (243 of which were

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

consolidated and 342 of which were in joint ventures accounted for using the equity method) compared to the results for the three and six months ended June 30, 2006, which included the operations of 556 properties (208 of which were consolidated and 348 of which were in joint ventures accounted for using the equity method).

Revenues

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

	Three months ended June 30, 2007					Six months ended June 30, 2007			
	2006	\$ Change	% Change		2006	\$ Change	% Change		
Revenues:									
Property rental	\$ 48,392	\$ 42,020	\$ 6,372	15.2	% \$ 94,623	\$ 81,195	\$ 13,428	16.5	
Management and franchise fees	5,143	5,181	(38)	(0.7)	% 10,351	10,340	11	0.1	
Tenant insurance	2,688	971	1,717	176.8	% 4,831	1,892	2,939	155.3	
Development fees	182	175	7	4.0	% 237	225	12	5.3	
Other income	145	184	(39)	(21.2)	% 284	249	35	14.1	
Total revenues	\$ 56,550	\$ 48,531	\$ 8,019	16.5	% \$ 110,326	\$ 93,901	\$ 16,425	17.5	

Property Rental The increase in property rental revenue for the three and six months ended June 30, 2007 consists of \$4,500 and \$9,240, respectively, associated with acquisitions completed in 2007 and 2006, \$1,454 and \$3,394, respectively, from rate increases at stabilized properties, and \$418 and \$794, respectively, from increases in occupancy at lease-up properties.

Management and Franchise Fees Revenue from management and franchise fees have remained fairly stable. Increased revenues at our joint venture, franchise, and third-party managed sites related to rental rate and occupancy increases have been offset by lost management fees due to the termination of certain management agreements.

Tenant Insurance The increase in tenant insurance revenues is due to the introduction of our captive insurance program at all wholly-owned properties in October 2006. In addition, during the six months ended June 30, 2007, we promoted the tenant insurance program and successfully increased sales of insurance policies in excess of 25%. Formerly, insurance revenues included only fee income paid by a third party insurance company.

Expenses

The following table sets forth information on expenses for the periods indicated:

	Three months ended June 30,					Six months ended June 30,				
	2007	2006	\$ Change	% Change		2007	2006	\$ Change	% Change	
Expenses:										
Property operations	\$ 17,352	\$ 15,248	\$ 2,104	13.8	%	\$ 34,248	\$ 29,990	\$ 4,258	14.2	%
Tenant insurance	1,217	589	628	106.6	%	2,190	1,222	968	79.2	%
Unrecovered development and acquisition costs	159	24	135	562.5	%	409	342	67	19.6	%
General and administrative	8,968	8,747	221	2.5	%	18,208	17,992	216	1.2	%
Depreciation and amortization	9,123	9,057	66	0.7	%	17,919	18,333	(414)	(2.3)	)%
Total expenses	\$ 36,819	\$ 33,665	\$ 3,154	9.4	%	\$ 72,974	\$ 67,879	\$ 5,095	7.5	%

Property Operations The increase in property operations expense for the three and six months ended June 30, 2007 consists of \$1,344 and \$3,057, respectively, associated with acquisitions completed in 2007 and 2006, \$760 and \$1,201, respectively, from increases in utilities and advertising expenses at existing properties.

Tenant Insurance The increase in tenant insurance expense is due to the introduction of our captive insurance program at all wholly-owned properties in October 2006.

Unrecovered Development/Acquisition Costs Unrecovered development and acquisition costs have increased when compared to the prior year due to increased acquisition volume and competition for raw land and operating properties.

General and Administrative General and administrative costs remained relatively constant due to the fact that the integration of the Storage USA properties was completed prior to the periods presented and as no similar large acquisitions have occurred.

Depreciation and Amortization The decrease in depreciation and amortization expense for the six months ended June 30, 2007 is due primarily to the fact that the customer relationship intangibles related to the properties acquired in the Storage USA acquisition in July 2005 were fully amortized as of January 2007. This decrease is offset by additional depreciation and amortization expense from other acquisitions made in 2007 and 2006, causing the increase in depreciation and amortization expense for the three months ended June 30, 2007.

Other Revenues and Expenses

The following table sets forth information on other revenues and expenses for the periods indicated:

	Three months ended June				Six months ended June			
	30, 2007	2006	\$ Change	% Change	30, 2007	2006	\$ Change	% Change
Other revenue and expenses:								
Interest expense	\$ (15,437)	\$ (12,784)	\$ (2,653)	20.8	% \$ (28,833)	\$ (24,769)	\$ (4,064)	16.4
Interest income	3,668	148	3,520	2,378.4	% 5,116	630	4,486	712.1
Minority interest - Operating Partnership	(515)	(225)	(290)	128.9	% (899)	(279)	(620)	222.2
Minority interest - other	56		56	(100.0)	% 40		40	(100.0)
Equity in earnings of real estate ventures	1,192	1,087						