Extra Space Storage Inc.
Form 10-Q
November 07, 2011
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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 September 30, 2011

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	**20-1076777**
(State or other jurisdiction of incorporation or organization)	(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 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 x No o

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 x	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

The number of shares outstanding of the registrant s common stock, par value $0.01 per share, as of October 31, 2011 was 94,373,253.

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EXTRA SPACE STORAGE INC.

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STATEMENT ON FORWARD-LOOKING INFORMATION

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

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

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

- changes in general economic conditions, the real estate industry and the markets in which we operate;

- the effect of competition from new and existing self-storage facilities or other storage alternatives, which could cause rents and occupancy rates to decline;

- difficulties in our ability to evaluate, finance, complete and integrate acquisitions and developments successfully and to lease up those properties, which could adversely affect our profitability;

- potential liability for uninsured losses and environmental contamination;

- the impact of the regulatory environment as well as national, state, and local laws and regulations including, without limitation, those governing real estate investment trusts (REITs), which could increase our expenses and reduce our cash available for distribution;

- disruptions in credit and financial markets and resulting difficulties in raising capital or obtaining credit at reasonable rates or at all, which could impede our ability to grow;
- increased interest rates and operating costs;
- reductions in asset valuations and related impairment charges;
- delays in the development and construction process, which could adversely affect our profitability;
- the failure to maintain our REIT status for federal income tax purposes;
- economic uncertainty due to the impact of war or terrorism, which could adversely affect our business plan; and
- our ability to attract and retain qualified personnel and management members.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Extra Space Storage Inc.

Condensed Consolidated Balance Sheets

(amounts in thousands, except share data)

		September 30, 2011 (unaudited)		December 31, 2010
Assets:				
Real estate assets:				
Net operating real estate assets	$	2,051,567	$	1,935,319
Real estate under development		8,621		37,083
Net real estate assets		2,060,188		1,972,402
Investments in real estate ventures		134,219		140,560
Cash and cash equivalents		33,895		46,750
Restricted cash		30,352		30,498
Receivables from related parties and affiliated real estate joint ventures		61,184		10,061
Other assets, net		54,390		48,197
Total assets	$	2,374,228	$	2,248,468
Liabilities, Noncontrolling Interests and Equity:				
Notes payable	$	869,866	$	871,403
Notes payable to trusts		119,590		119,590
Exchangeable senior notes		87,663		87,663
Discount on exchangeable senior notes		(897)		(2,205)
Lines of credit		166,000		170,467
Accounts payable and accrued expenses		39,891		34,210
Other liabilities		30,046		28,269
Total liabilities		1,312,159		1,309,397
Commitments and contingencies				
Equity:				
Extra Space Storage Inc. stockholders equity:				
Preferred stock, $0.01 par value, 50,000,000 shares authorized, no shares issued or outstanding				
Common stock, $0.01 par value, 300,000,000 shares authorized, 94,357,528 and 87,587,322 shares issued and outstanding at September 30, 2011 and December 31, 2010, respectively		943		876
Paid-in capital		1,281,378		1,148,820
Accumulated other comprehensive deficit		(7,819)		(5,787)
Accumulated deficit		(267,122)		(262,508)
Total Extra Space Storage Inc. stockholders equity		1,007,380		881,401
		29,665		29,733

Noncontrolling interest represented by Preferred Operating Partnership units, net of $100,000 note receivable				
Noncontrolling interests in Operating Partnership		23,924		26,803
Other noncontrolling interests		1,100		1,134
Total noncontrolling interests and equity		1,062,069		939,071
Total liabilities, noncontrolling interests and equity	$	2,374,228	$	2,248,468

See accompanying notes to unaudited condensed consolidated financial statements.

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Extra Space Storage Inc.

Condensed Consolidated Statements of Operations

(amounts in thousands, except share data)

(unaudited)

	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Revenues:				
Property rental	$ 69,475	$ 59,332	$ 195,265	$ 172,261
Management and franchise fees	6,353	5,851	18,464	17,056
Tenant reinsurance	8,269	6,796	22,889	19,026
Total revenues	84,097	71,979	236,618	208,343
Expenses:				
Property operations	24,270	21,334	70,326	64,231
Tenant reinsurance	1,596	1,736	4,593	4,416
Unrecovered development and acquisition costs	346	211	2,165	423
Loss on sublease		2,000		2,000
General and administrative	12,306	10,618	36,396	32,903
Depreciation and amortization	14,364	12,519	42,041	37,140
Total expenses	52,882	48,418	155,521	141,113
Income from operations	31,215	23,561	81,097	67,230
Interest expense	(16,756)	(15,702)	(49,431)	(49,209)
Non-cash interest expense related to amortization of discount on exchangeable senior notes	(440)	(416)	(1,308)	(1,236)
Interest income	185	178	556	714
Interest income on note receivable from Preferred Operating Partnership unit holder	1,213	1,213	3,638	3,638
Income before equity in earnings of real estate ventures and income tax expense	15,417	8,834	34,552	21,137
Equity in earnings of real estate ventures	1,873	1,736	6,060	4,796
Income tax expense	62	(1,088)	(603)	(3,347)
Net income	17,352	9,482	40,009	22,586
Net income allocated to Preferred Operating Partnership noncontrolling interests	(1,598)	(1,524)	(4,682)	(4,510)
Net income allocated to Operating Partnership and other noncontrolling interests	(493)	(291)	(1,156)	(661)
Net income attributable to common stockholders	$ 15,261	$ 7,667	$ 34,171	$ 17,415
Net income per common share				
Basic	$ 0.16	$ 0.09	$ 0.37	$ 0.20
Diluted	$ 0.16	$ 0.09	$ 0.37	$ 0.20
Weighted average number of shares				
Basic	94,314,429	87,484,731	91,277,261	87,244,161
Diluted	98,867,803	92,189,852	95,866,290	91,969,869

Cash dividends paid per common share	$	0.14	$	0.10	$	0.42	$	0.30

See accompanying notes to unaudited condensed consolidated financial statements.

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Extra Space Storage Inc.

Condensed Consolidated Statement of Equity

(amounts in thousands, except share data)

(unaudited)

	Noncontrolling Interests			**Extra Space Storage Inc. Stockholders Equity**					
	Preferred Operating Partnership	**Operating Partnership**	**Other**	**Shares**	**Par Value**	**Paid-in Capital**	**Accumulated Other Comprehensive Deficit**	**Accumulated Deficit**	**Total Equity**
Balances at December 31, 2010	$ 29,733	$ 26,803	$ 1,134	87,587,322	$ 876	$ 1,148,820	$ (5,787)	$ (262,508)	$ 939,071
Issuance of common stock upon the exercise of options				931,921	9	12,105			12,114
Restricted stock grants issued				222,130	2				2
Restricted stock grants cancelled				(12,909)					
Issuance of common stock, net of offering costs				5,335,423	53	112,299			112,352
Compensation expense related to stock-based awards						3,895			3,895
Redemption of Operating Partnership units for common stock		(2,344)		293,641	3	2,341			
Redemption of Operating Partnership units for cash		(271)							(271)
Comprehensive income:									
Net income (loss)	4,682	1,164	(8)					34,171	40,009
Change in fair value of interest rate swap	(21)	(62)					(2,032)		(2,115)
Total comprehensive income									37,894
Tax effect from vesting of restricted stock grants and stock option exercises						1,918			1,918
Distributions to Operating Partnership units held by noncontrolling interests	(4,729)	(1,366)							(6,095)
Distributions to other noncontrolling interests			(26)						(26)
Dividends paid on common stock at $0.42 per share								(38,785)	(38,785)
Balances at September 30, 2011	$ 29,665	$ 23,924	$ 1,100	94,357,528	$ 943	$ 1,281,378	$ (7,819)	$ (267,122)	$ 1,062,069

See accompanying notes to unaudited condensed consolidated financial statements.

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Extra Space Storage Inc.

Condensed Consolidated Statements of Cash Flows

(amounts in thousands)
(unaudited)

	Nine Months Ended September 30, 2011	2010
Cash flows from operating activities:		
Net income	$ 40,009	$ 22,586
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	42,041	37,140
Amortization of deferred financing costs	3,720	3,323
Non-cash interest expense related to amortization of discount on exchangeable senior notes	1,308	1,236
Compensation expense related to stock-based awards	3,895	3,457
Loss on sublease		2,000
Distributions from real estate ventures in excess of earnings	4,665	4,830
Changes in operating assets and liabilities:		
Receivables from related parties and affiliated real estate joint ventures	(301)	(1,237)
Other assets	1,108	(2,162)
Accounts payable and accrued expenses	5,681	2,059
Other liabilities	(1,469)	1,498
Net cash provided by operating activities	100,657	74,730
Cash flows from investing activities:		
Acquisition of real estate assets	(108,403)	(24,648)
Development and construction of real estate assets	(6,315)	(28,523)
Proceeds from sale of properties to joint venture		15,750
Investments in real estate ventures	(3,737)	(9,371)
Return of investment in real estate ventures	4,614	7,432
Change in restricted cash	146	6,315
Purchase of affiliated joint venture note receivable	(51,000)	
Purchase of equipment and fixtures	(4,493)	(1,450)
Net cash used in investing activities	(169,188)	(34,495)
Cash flows from financing activities:		
Proceeds from the sale of common stock, net of transaction costs	112,352	
Proceeds from notes payable and lines of credit	370,242	131,124
Principal payments on notes payable and lines of credit	(389,706)	(248,032)
Deferred financing costs	(4,149)	(2,674)
Investments from noncontrolling interests		87
Redemption of Operating Partnership units held by noncontrolling interest	(271)	(4,116)
Net proceeds from exercise of stock options	12,114	5,101
Dividends paid on common stock	(38,785)	(26,206)
Distributions to noncontrolling interests (Operating Partnership and other)	(6,121)	(5,671)
Net cash provided by (used in) financing activities	55,676	(150,387)
Net decrease in cash and cash equivalents	(12,855)	(110,152)
Cash and cash equivalents, beginning of the period	46,750	131,950
Cash and cash equivalents, end of the period	$ 33,895	$ 21,798

See accompanying notes to unaudited condensed consolidated financial statements.

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Extra Space Storage Inc.

Condensed Consolidated Statements of Cash Flows

(amounts in thousands)
(unaudited)

	Nine Months Ended September 30, 2011		2010	
Supplemental schedule of cash flow information				
Interest paid, net of amounts capitalized	$	45,048	$	45,593
Supplemental schedule of noncash investing and financing activities:				
Deconsolidation of joint ventures due to application of Accounting Standards Codification 810:				
Real estate assets, net	$		$	(42,739)
Investments in real estate ventures				404
Receivables from related parties and affiliated real estate joint ventures				21,142
Other assets and other liabilities				(51)
Notes payable				21,348
Other noncontrolling interests				(104)
Redemption of Operating Partnership units held by noncontrolling interests for common stock:				
Noncontrolling interests in Operating Partnership	$	2,344	$	
Common stock and paid-in capital		(2,344)		
Tax effect from vesting of restricted stock grants and stock option exercises:				
Other assets	$	1,918	$	995
Paid-in capital		(1,918)		(995)
Acquisitions of real estate assets				
Real estate assets, net	$	8,660	$	6,475
Notes payable		(8,660)		(6,475)

See accompanying notes to unaudited condensed consolidated financial statements.

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EXTRA SPACE STORAGE INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

Amounts in thousands, except property and share data

1. ORGANIZATION

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

The Company invests in self-storage facilities by acquiring or developing wholly-owned facilities or by acquiring an equity interest in real estate entities. At September 30, 2011, the Company had direct and indirect equity interests in 676 operating storage facilities. In addition, the Company managed 178 properties for franchisees and third parties, bringing the total number of operating properties which it owns and/or manages to 854. These properties are located in 34 states and Washington, D.C.

The Company operates in three distinct segments: (1) property management, acquisition and development; (2) rental operations; and (3) tenant reinsurance. The Company s property management, acquisition and development activities include managing, acquiring, developing and selling self-storage facilities. On June 2, 2009, the Company announced the wind-down of its development activities. As of September 30, 2011, there was one remaining development project in process. The Company expects to complete this project by the end of 2011. The rental operations activities include rental operations of self-storage facilities. No single tenant accounts for more than 5% of rental income. Tenant reinsurance activities include the reinsurance of risks relating to the loss of goods stored by tenants in the Company s self storage facilities.

2. BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements of the Company are presented on the accrual basis of accounting in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they may not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (including normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and nine months ended September 30, 2011 are not necessarily indicative of results that may be expected for the year ended December 31, 2011. The condensed consolidated balance sheet as of December 31, 2010 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, 2010 as filed with the Securities and Exchange Commission.

3. FAIR VALUE DISCLOSURES

Assets and Liabilities Measured at Fair Value on a Recurring Basis

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

		Fair Value Measurements at Reporting Date Using		
Description	**September 30, 2011**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Other liabilities - Cash Flow Hedge Swap Agreements	$ (8,189)	$	$ (8,189)	$

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

There were no transfers of assets and liabilities between Level 1 and Level 2 during the nine months ended September 30, 2011. The Company did not have any significant assets or liabilities that are re-measured on a recurring basis using significant unobservable inputs (Level 3) for the nine months ended September 30, 2011.

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

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

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

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

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

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

Fair Value of Financial Instruments

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 September 30, 2011 and December 31, 2010 approximate fair value. The fair values of the Company s notes receivable, fixed rate notes payable and notes payable to trusts and exchangeable senior notes are as follows:

	September 30, 2011		December 31, 2010	
	Fair Value	Carrying Value	Fair Value	Carrying Value
Note receivable from Preferred Operating Partnership unit holder	$ 103,994	$ 100,000	$ 115,696	$ 100,000
Fixed rate notes payable and notes payable to trusts	$ 937,327	$ 873,137	$ 777,575	$ 731,588
Exchangeable senior notes	$ 91,555	$ 87,663	$ 118,975	$ 87,663

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4. NET INCOME PER COMMON SHARE

Basic net income per common share is computed by dividing net income by the weighted average common shares outstanding, including unvested share based payment awards that contain a non-forfeitable right to dividends or dividend equivalents. Diluted earnings per common share measures the performance of the Company over the reporting period while giving effect to all potential common shares that were dilutive and outstanding during the period. The denominator includes the weighted average number of basic shares and the number of additional common shares that would have been outstanding if the potential common shares that were dilutive had been issued and is calculated using either the treasury stock or if-converted method. Potential common shares are securities (such as options, convertible debt, exchangeable Series A Participating Redeemable Preferred Operating Partnership units (Preferred OP units) and exchangeable Operating Partnership units (OP units)) that do not have a current right to participate in earnings but could do so in the future by virtue of their option or conversion right. In computing the dilutive effect of convertible securities, net income is adjusted to add back any changes in earnings in the period associated with the convertible security. The numerator also is adjusted for the effects of any other non-discretionary changes in income or loss that would result from the assumed conversion of those potential common shares. In computing diluted earnings per share, only potential common shares that are dilutive, those that reduce earnings per share, are included.

The Company s Operating Partnership had $87,663 of exchangeable senior notes issued and outstanding as of September 30, 2011 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 $23.45 per share at September 30, 2011, 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 third quarter of 2011; therefore holders of the exchangeable senior notes may not elect to convert them during the fourth quarter of 2011.

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, Accounting Standards Codification (ASC) 260, *Earnings Per Share,* requires an assumption that shares will be used to pay the exchange obligations in excess of the accreted principal amount, and requires that those shares be included in the Company s calculation of weighted average common shares outstanding for the diluted earnings per share computation. No shares related to the exchangeable senior notes were included in the computations for the three and nine month periods ended September 30, 2011 or 2010 because there was no excess over the accreted principal for these periods.

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

For the three months ended September 30, 2011 and 2010, options to purchase 120,634 and 1,161,799 shares of common stock, and for the nine months ended September 30, 2011 and 2010, 106,726 and 2,187,449 shares of common stock, respectively, were excluded from the computation of earnings per share as their effect would have been anti-dilutive. All restricted stock grants have been included in basic and diluted shares outstanding because such shares earn a non-forfeitable dividend and carry voting rights.

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

	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Net income attributable to common stockholders	$ 15,261	$ 7,667	$ 34,171	$ 17,415
Income allocated to noncontrolling interest - Preferred Operating Partnership and Operating Partnership	2,092	1,827	5,846	5,217
Fixed component of income allocated to noncontrolling interest - Preferred Operating Partnership	(1,438)	(1,438)	(4,313)	(4,313)
Net income for diluted computations	$ 15,915	$ 8,056	$ 35,704	$ 18,319
Weighted average common shares outstanding:				
Average number of common shares outstanding - basic	94,314,429	87,484,731	91,277,261	87,244,161
Operating Partnership units	3,049,935	3,356,963	3,049,935	3,356,963
Preferred Operating Partnership units	989,980	989,980	989,980	989,980
Dilutive and cancelled stock options	513,459	358,178	549,114	378,765
Average number of common shares outstanding - diluted	98,867,803	92,189,852	95,866,290	91,969,869
Net income per common share				
Basic	$ 0.16	$ 0.09	$ 0.37	$ 0.20
Diluted	$ 0.16	$ 0.09	$ 0.37	$ 0.20

5. PROPERTY ACQUISITIONS

The following table summarizes the Company s acquisitions of operating properties for the nine months ended September 30, 2011 and does not include improvements made to existing assets:

			Consideration Paid				Acquisition Date Fair Value				
Property Location	Number of Properties	Date of Acquisition	Total Paid	Cash Paid	Loan Assumed	Net Liabilities/ (Assets) Assumed	Land	Building	Intangible	Closing costs - expensed	Source of Acquisition
Utah, Texas	2	4/1/2011	$ 7,262	$ 7,205	$	$ 57	$ 1,512	$ 5,548	$ 188	$ 14	Affiliated joint venture
California	1	4/7/2011	8,207	8,150		57	2,211	5,829	163	4	Unrelated third party
Tennessee	1	4/15/2011	2,539	2,514		25	652	1,791	79	17	Unrelated third party
Colorado	1	5/25/2011	3,540	2,262	1,290	(12)	407	3,077	61	(5)	Unrelated third party
Virginia	1	5/26/2011	10,514	5,205	5,463	(154)	932	9,349	202	31	Unrelated third party
New Jersey	1	6/2/2011	4,963	4,959		4	1,644	3,115	135	69	Affiliated joint venture
Colorado	1	6/10/2011	4,600	2,664	1,907	29	296	4,199	98	7	Unrelated third party
Nevada	1	6/22/2011	3,355	3,339		16	1,441	1,810	98	6	Unrelated third party
Ohio, Indiana, Kentucky	15	6/27/2011	39,773	39,387		386	13,587	24,991	903	292	Unrelated third party
Maryland	1	7/8/2011	5,785	5,795		(10)	1,303	4,218	125	139	Unrelated third party
Maryland	1	8/1/2011	7,352	7,342		10	764	6,340	143	105	Unrelated third party
Texas	1	8/2/2011	2,402	2,353		49	979	1,346	73	4	Unrelated third party

On January 1, 2011, the Company paid $320 in cash to obtain its joint venture partners   equity interests in a joint venture. No gain or loss was recognized on this transaction. The joint venture owned a single stabilized self-storage property located in Pennsylvania and was previously accounted for under the equity method. This property is now wholly owned and consolidated by the Company.

6. RECEIVABLES FROM RELATED PARTIES AND AFFILIATED REAL ESTATE JOINT VENTURES

During September 2011, the Company purchased a note receivable from Bank of America for $51,000. The receivable is due from Storage Associates Holdco, LLC, a joint venture in which the Company holds a 10% equity interest. The note is due March 2012 and has a monthly interest rate of LIBOR plus 185 basis points. The Company has eliminated the interest income related to its 10% ownership interest.

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7. VARIABLE INTERESTS

The Company has interests in three unconsolidated joint ventures with unrelated third parties which are variable interest entities (VIEs or the VIE JVs). The Company holds 10% to 39% of the equity interests in the VIE JVs, and has 50% of the voting rights in each of the VIE JVs. Qualification as a VIE was based on the determination that the equity investments at risk for each of these joint ventures were not sufficient based on a qualitative and quantitative analysis performed by the Company. The Company performed a qualitative analysis for these joint ventures to determine which party was the primary beneficiary of each VIE. The Company determined that since the powers to direct the activities most significant to the economic performance of these entities are shared equally by the Company and its joint venture partners, there is no primary beneficiary. Accordingly, these interests are recorded using the equity method.

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

The Company guarantees the mortgage notes payable for two of the VIE JVs. The Company s maximum exposure to loss for these joint ventures as of September 30, 2011 is the total of the guaranteed loan balances, the payables due to the Company and the Company s investment balances in the joint ventures. The Company believes that the risk of incurring a material loss as a result of having to perform on the loan guarantees is unlikely and, therefore, no liability has been recorded related to these guarantees. Also, repossessing and/or selling the self-storage facility and land that collateralize the loans could provide funds sufficient to reimburse the Company. Additionally, the Company believes the payables to the Company are collectible.

The following table compares the Company s liability balance to the respective VIE JVs and the maximum exposure to loss related to the VIE JVs as of September 30, 2011 after netting such liability balance:

	Liability Balance	**Investment Balance**	**Balance of Guaranteed Loan**	**Payables to Company**	**Maximum Exposure to Loss**	**Difference**
Extra Space of Montrose Avenue LLC	$	$ 1,202	$ 4,838	$ 2,478	$ 8,518	$ (8,518)
Extra Space of Sacramento One LLC		(893)	4,307	6,099	9,513	(9,513)
Storage Associates Holdco, LLC		1,817		53,976	55,793	(55,793)
	$	$ 2,126	$ 9,145	$ 62,553	$ 73,824	$ (73,824)

Included in payables to Company for Storage Associates Holdco, LLC is a first mortgage secured by the six self-storage properties which was purchased by the Company from the bank lender in September 2011. The note payable is due March 2012 and pays interest monthly at LIBOR plus 185 basis points.

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

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

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The following is a tabular comparison of the liabilities the Company has recorded as a result of its involvement with the Trusts to the maximum exposure to loss the Company is subject to as a result of such involvement as of September 30, 2011:

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

The Company had no consolidated VIEs during the nine months ended September 30, 2011 or 2010.

8. DERIVATIVES

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

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

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

The following table summarizes the terms of the Company s derivative financial instruments at September 30, 2011:

Hedge Product	Hedge Type	Notional Amounts	Strike	Effective Dates	Maturity Dates
Cash Flow Hedge Swap Agreements	Cash Flow	$8,462 - $63,000	4.24% - 6.98%	2/1/2009 - 7/1/2010	6/30/2013 - 6/27/2016

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

Type	Classification of Income (Expense)	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Cash Flow Hedge Swap Agreements	Interest expense	$ (940)	$ (1,196)	$ (2,954)	$ (2,469)

Information relating to the gains recognized on the interest rate swap agreements is as follows:

Type	Gain (loss) recognized in OCI September 30, 2011	Location of amounts reclassified from OCI into income	Gain (loss) reclassified from OCI Nine Months Ended September 30, 2011
Cash Flow Hedge Swap Agreements	$ (2,115)	Interest expense	$ (2,954)

The interest rate swap agreements were highly effective for the three and nine months ended September 30, 2011. The gain (loss) reclassified from other comprehensive income (OCI) in the preceding table represents the effective portion of the Company s cash flow hedges reclassified from OCI to interest expense during the nine months ended September 30, 2011.

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

	Asset (Liability) Derivatives					
	September 30, 2011			December 31, 2010		
Derivatives designated as hedging instruments:	**Balance Sheet Location**		**Fair Value**	**Balance Sheet Location**		**Fair Value**
Cash Flow Hedge Swap Agreements	Other liabilities	$	(8,189)	Other liabilities	$	(6,074)

9. NONCONTROLLING INTEREST REPRESENTED BY PREFERRED OPERATING PARTNERSHIP UNITS

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

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

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

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

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

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

10. NONCONTROLLING INTEREST IN OPERATING PARTNERSHIP

The Company s interest in its properties is held through the Operating Partnership. ESS Holding Business Trust I, a wholly owned subsidiary of the Company, is the sole general partner of the Operating Partnership. The Company, through ESS Holding Business Trust II, a wholly owned subsidiary of the Company, is also a limited partner of the Operating Partnership. Between its general partner and limited partner interests, the Company held a 95.9% majority ownership interest therein as of September 30, 2011. The remaining ownership interests in the Operating Partnership (including Preferred OP units) of 4.1% are held by certain former owners of assets acquired by the Operating Partnership. As of September 30, 2011, the Operating Partnership had 3,049,935 common OP units outstanding.

The noncontrolling interest in the Operating Partnership represents common OP units that are not owned by the Company. In conjunction with the formation of the Company and as a result of subsequent acquisitions, certain persons and entities contributing interests in properties to the Operating Partnership received limited partnership units in the form of OP units. Limited partners who received OP units in the formation transactions or in exchange for contributions for interests in properties have the right to require the

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Operating Partnership to redeem part or all of their common OP units for cash based upon the fair market value of an equivalent number of shares of the Company s common stock (ten-day average) at the time of the redemption. Alternatively, the Company may, at its option, elect to acquire those OP units in exchange for shares of its common stock on a one-for-one basis, subject to anti-dilution adjustments provided in the Partnership Agreement. The ten-day average closing stock price at September 30, 2011 was $19.70 and there were 3,049,935 common OP units outstanding. Assuming that all of the unit holders exercised their right to redeem all of their common OP units on September 30, 2011 and the Company elected to pay the noncontrolling members cash, the Company would have paid $60,084 in cash consideration to redeem the OP units.

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

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

11. OTHER NONCONTROLLING INTERESTS

Other noncontrolling interests represent the ownership interests of various third parties in three consolidated self-storage properties as of September 30, 2011. Two of these consolidated properties were under development, and one was in the lease-up stage at September 30, 2011. The ownership interests of the third-party owners range from 5.0% to 27.6%. Other noncontrolling interests are included in the stockholders equity section of the Company s condensed consolidated balance sheet. The income or losses attributable to these third-party owners based on their ownership percentages are reflected in net income allocated to Operating Partnership and other noncontrolling interests in the condensed consolidated statement of operations.

12. STOCK OFFERING

In May 2011, the Company closed a public stock offering of 5,335,423 shares of its common stock at an offering price of $21.16 per share. The Company received gross proceeds of $112,898. Transaction costs were $546 for net proceeds of $112,352.

13. LOSS ON SUBLEASE

During the quarter ended September 30, 2010, a $2,000 charge was recorded as a result of the bankruptcy of a tenant subleasing office space from the Company in Memphis, Tennessee. The Memphis, Tennessee office lease is a liability that was assumed in the Storage USA acquisition in July 2005. The increase in this lease obligation liability was recognized through a $2,000 charge, which is included in loss on sublease in the condensed consolidated statement of operations.

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14. SEGMENT INFORMATION

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

	September 30, 2011	December 31, 2010
Balance Sheet		
Investment in real estate ventures		
Rental operations	$ 134,219	$ 140,560
Total assets		
Property management, acquisition and development	$ 395,972	$ 400,910
Rental operations	1,957,662	1,831,150
Tenant reinsurance	20,594	16,408
	$ 2,374,228	$ 2,248,468

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	Three months ended September 30, 2011	2010	Nine months ended September 30, 2011	2010
Statement of Operations				
Total revenues				
Property management, acquisition and development	$ 6,353	$ 5,851	$ 18,464	$ 17,056
Rental operations	69,475	59,332	195,265	172,261
Tenant reinsurance	8,269	6,796	22,889	19,026
	$ 84,097	$ 71,979	$ 236,618	$ 208,343
Operating expenses, including depreciation and amortization				
Property management, acquisition and development	$ 13,237	$ 13,378	$ 40,773	$ 36,800
Rental operations	38,049	33,304	110,155	99,897
Tenant reinsurance	1,596	1,736	4,593	4,416
	$ 52,882	$ 48,418	$ 155,521	$ 141,113
Income (loss) from operations				
Property management, acquisition and development	$ (6,884)	$ (7,527)	$ (22,309)	$ (19,744)
Rental operations	31,426	26,028	85,110	72,364
Tenant reinsurance	6,673	5,060	18,296	14,610
	$ 31,215	$ 23,561	$ 81,097	$ 67,230
Interest expense				
Property management, acquisition and development	$ (926)	$ (830)	$ (2,531)	$ (2,407)
Rental operations	(16,270)	(15,288)	(48,208)	(48,038)
	$ (17,196)	$ (16,118)	$ (50,739)	$ (50,445)
Interest income				
Property management, acquisition and development	$ 182	$ 175	$ 548	$ 706
Tenant reinsurance	3	3	8	8
	$ 185	$ 178	$ 556	$ 714
Interest income on note receivable from Preferred Operating Partnership unit holder				
Property management, acquisition and development	$ 1,213	$ 1,213	$ 3,638	$ 3,638
Equity in earnings of real estate ventures				
Rental operations	$ 1,873	$ 1,736	$ 6,060	$ 4,796
Income tax expense				
Property management, acquisition and development	$ 2,570	$	$ 6,330	$
Rental operations	(169)		(527)	
Tenant reinsurance	(2,339)	(1,088)	(6,406)	(3,347)
	$ 62	$ (1,088)	$ (603)	$ (3,347)
Net income (loss)				
Property management, acquisition and development	$ (3,845)	$ (6,969)	$ (14,324)	$ (17,807)
Rental operations	16,860	12,476	42,435	29,122

Tenant reinsurance	4,337	3,975	11,898	11,271
	$ 17,352	$ 9,482	$ 40,009	$ 22,586
Depreciation and amortization expense				
Property management, acquisition and development	$ 585	$ 549	$ 2,212	$ 1,474
Rental operations	13,779	11,970	39,829	35,666
	$ 14,364	$ 12,519	$ 42,041	$ 37,140
Statement of Cash Flows				