Extra Space Storage Inc.
Form 10-Q
August 07, 2009
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2009

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 o 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 July 31, 2009 was 86,438,578.

Table of Contents

EXTRA SPACE STORAGE INC.

TABLE OF CONTENTS

STATEMENT ON FORWARD-LOOKING INFORMATION	3
PART I. FINANCIAL INFORMATION	4
ITEM 1. FINANCIAL STATEMENTS	4
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS	8
ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS	31
ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK	42
ITEM 4. CONTROLS AND PROCEDURES	42
PART II. OTHER INFORMATION	43
ITEM 1. LEGAL PROCEEDINGS	43
ITEM 1A. RISK FACTORS	43
ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS	43
ITEM 3. DEFAULTS UPON SENIOR SECURITIES	43
ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS	43
ITEM 5. OTHER INFORMATION	43
ITEM 6. EXHIBITS	44
SIGNATURES	45

Table of Contents

STATEMENT ON FORWARD-LOOKING INFORMATION

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

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

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

- 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, or REITs, which could increase our expenses and reduce our cash available for distribution;
- the possibility that the joint venture transaction with Harrison Street Real Estate Capital, LLC may not close on the terms previously disclosed or at all, or that the expected benefits from the transaction may not be realized;
- recent disruptions in credit and financial markets and resulting 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;
- economic uncertainty due to the impact of war or terrorism, which could adversely affect our business plan;
- the successful realignment of our executive management team; and

- our ability to attract and retain qualified personnel and management members.

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Extra Space Storage Inc.

Condensed Consolidated Balance Sheets

(in thousands, except share data)

	June 30, 2009 (unaudited)	December 31, 2008
Assets:		
Real estate assets:		
Net operating real estate assets	$ 1,940,232	$ 1,938,922
Real estate under development	89,310	58,734
Net real estate assets	2,029,542	1,997,656
Investments in real estate ventures	132,272	136,791
Cash and cash equivalents	131,551	63,972
Restricted cash	40,927	38,678
Receivables from related parties and affiliated real estate joint ventures	5,666	11,335
Other assets, net	42,486	42,576
Total assets	$ 2,382,444	$ 2,291,008
Liabilities, Noncontrolling Interests and Equity:		
Notes payable	$ 1,065,502	$ 943,598
Notes payable to trusts	119,590	119,590
Exchangeable senior notes	95,163	209,663
Discount on exchangeable senior notes	(5,070)	(13,031)
Lines of credit	100,000	27,000
Accounts payable and accrued expenses	34,462	35,128
Other liabilities	26,823	22,267
Total liabilities	1,436,470	1,344,215
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, 86,432,978 and 85,790,331 shares issued and outstanding at June 30, 2009 and December 31, 2008, respectively	864	858
Paid-in capital	1,132,073	1,130,964
Accumulated other comprehensive income	189	
Accumulated deficit	(254,500)	(253,052)
Total Extra Space Storage Inc. stockholders equity	878,626	878,770
	29,891	29,837

Noncontrolling interest represented by Preferred Operating Partnership units, net of $100,000 note receivable				
Noncontrolling interest in Operating Partnership		35,866		36,628
Other noncontrolling interests		1,591		1,558
Total noncontrolling interests and equity		945,974		946,793
Total liabilities, noncontrolling interests and equity	$	2,382,444	$	2,291,008

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

Extra Space Storage Inc.

Condensed Consolidated Statements of Operations

(in thousands, except share data)

(unaudited)

	Three months ended June 30, 2009	Three months ended June 30, 2008 (As revised-see Note 2)	Six months ended June 30, 2009	Six months ended June 30, 2008 (As revised-see Note 2)
Revenues:				
Property rental	$ 58,705	$ 57,885	$ 118,114	$ 114,909
Management and franchise fees	5,275	5,343	10,494	10,420
Tenant reinsurance	5,085	3,980	9,704	7,458
Other income	3	128	10	256
Total revenues	69,068	67,336	138,322	133,043
Expenses:				
Property operations	21,567	20,863	44,434	41,504
Tenant reinsurance	1,471	1,370	2,732	2,532
Unrecovered development and acquisition costs	18,801	1,428	18,883	1,592
Severance costs associated with wind-down of development program	1,400		1,400	
General and administrative	10,615	10,183	21,213	20,062
Depreciation and amortization	12,840	11,697	25,363	23,278
Total expenses	66,694	45,541	114,025	88,968
Income before interest, equity in earnings of real estate ventures, gain on repurchase of exchangeable senior notes, loss on sale of investments available for sale and income tax expense	2,374	21,795	24,297	44,075
Interest expense	(15,816)	(15,962)	(31,611)	(32,316)
Non-cash interest expense related to amortization of discount on exchangeable senior notes	(563)	(1,059)	(1,404)	(2,088)
Interest income	321	870	853	1,295
Interest income on note receivable from Preferred Operating Partnership unit holder	1,212	1,212	2,425	2,425
Equity in earnings of real estate ventures	1,641	1,373	3,536	2,595
Gain on repurchase of exchangeable senior notes	5,093		27,576	
Loss on sale of investments available for sale				(1,415)
Income tax expense	(943)	113	(1,591)	(187)
Net income (loss)	(6,681)	8,342	24,081	14,384
Net income allocated to Preferred Operating Partnership	(1,369)	(1,539)	(3,175)	(3,057)

noncontrolling interests								
Net (income) loss allocated to Operating Partnership and other noncontrolling interests		509		(306)		(828)		(495)
Net income (loss) attributable to common stockholders	$	(7,541)	$	6,497	$	20,078	$	10,832
Net income (loss) per common share								
Basic	$	(0.09)	$	0.09	$	0.23	$	0.15
Diluted	$	(0.09)	$	0.09	$	0.23	$	0.15
Weighted average number of shares								
Basic		86,397,618		73,900,524		86,170,270		70,034,123
Diluted		91,607,503		79,572,767		91,375,416		75,646,629
Cash dividends paid per common share	$		$	0.25	$	0.25	$	0.50

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

Extra Space Storage Inc.

Condensed Consolidated Statement of Equity

(in thousands, except share data)

(unaudited)

	Noncontrolling Interests				Extra Space Storage Inc. Stockholders Equity				
	Preferred OP	**OP**	**Other**	**Shares**	**Par Value**	**Paid-in Capital**	**Accumulated Other Comprehensive Income**	**Accumulated Deficit**	**Total Equity**
Balances at December 31, 2008	$ 29,837	$ 36,628	$ 1,558	85,790,331	$ 858	$ 1,130,964	$	$ (253,052)	$ 946,793
Restricted stock grants issued				538,865	5				5
Restricted stock grants cancelled				(11,146)					
Compensation expense related to stock-based awards						2,160			2,160
Noncontrolling interest consolidated as business acquisition			1,118						1,118
Investments from other noncontrolling interests			(615)						(615)
Repurchase of equity portion of exchangeable senior notes						(2,053)			(2,053)
Conversion of Operating Partnership units to common stock		(1,003)		114,928	1	1,002			
Comprehensive income:									
Net income (loss)	3,175	1,298	(470)					20,078	24,081
Change in fair value of interest rate swap	2	9					189		200
Total comprehensive income									24,281
Distributions to Operating Partnership units held by noncontrolling interests	(3,123)	(1,066)							(4,189)
Dividends paid on common stock at $0.25 per share								(21,526)	(21,526)
Balances at June 30, 2009	$ 29,891	$ 35,866	$ 1,591	86,432,978	$ 864	$ 1,132,073	$ 189	$ (254,500)	$ 945,974

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

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

	Six months ended June 30, 2009	Six months ended June 30, 2008 (As revised see Note 2)
Cash flows from operating activities:		
Net income	$ 24,081	$ 14,384
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	25,363	23,278
Amortization of deferred financing costs	1,881	1,708
Non-cash interest expense related to amortization of discount on exchangeable senior notes	1,404	2,088
Gain on repurchase of exchangeable senior notes	(27,576)	
Compensation expense related to stock-based awards	2,160	1,984
Loss on investments available for sale		1,415
Unrecovered development and acquisition costs	18,883	1,592
Severance costs associated with wind-down of development program	1,400	
Distributions from real estate ventures in excess of earnings	3,136	2,400
Changes in operating assets and liabilities:		
Receivables from related parties	(4,306)	(1,852)
Other assets	465	(525)
Accounts payable and accrued expenses	(1,762)	2,263
Other liabilities	4,003	1,384
Net cash provided by operating activities	49,132	50,119
Cash flows from investing activities:		
Acquisition of real estate assets	(24,001)	(37,017)
Development and construction of real estate assets	(43,293)	(31,124)
Proceeds from sale of real estate assets	4,652	340
Investments in real estate ventures	(1,155)	(3,050)
Net proceeds from sale of investments available for sale		21,812
Change in restricted cash	(2,239)	(2,703)
Purchase of equipment and fixtures	(471)	(885)
Net cash used in investing activities	(66,507)	(52,627)
Cash flows from financing activities:		
Repurchase of exchangeable senior notes	(80,853)	
Proceeds from notes payable and lines of credit	277,546	3,384
Principal payments on notes payable and lines of credit	(81,592)	(22,965)
Deferred financing costs	(4,432)	(542)
Proceeds from issuance of common shares, net		232,718
Net proceeds from exercise of stock options		872
Dividends paid on common stock	(21,526)	(37,088)
Distributions to noncontrolling interests in Operating Partnership	(4,189)	(5,411)
Net cash provided by financing activities	84,954	170,968
Net increase in cash and cash equivalents	67,579	168,460
Cash and cash equivalents, beginning of the period	63,972	17,377
Cash and cash equivalents, end of the period	$ 131,551	$ 185,837
Supplemental schedule of cash flow information		

Interest paid, net of amounts capitalized	$	31,752	$	31,509
Supplemental schedule of noncash investing and financing activities:				
Conversion of Operating Partnership Units held by noncontrolling interests for common stock	$	1,003	$	

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

Extra Space Storage Inc.
Notes to Condensed Consolidated Financial Statements (unaudited)

Amounts in thousands, except property and share data

1. ORGANIZATION

Extra Space Storage Inc. (the Company) is a self-administered and self-managed real estate investment trust (REIT), formed as a Maryland corporation on April 30, 2004 to own, operate, manage, acquire, develop and redevelop professionally managed self-storage facilities located throughout the United States. The Company continues the business of Extra Space Storage LLC and its subsidiaries, which had engaged in the self-storage business since 1977. The Company s interest in its properties is held through its operating partnership, Extra Space Storage LP (the Operating Partnership), which was formed on May 5, 2004. The Company s primary assets are general partner and limited partner interests in the Operating Partnership. This structure is commonly referred to as an umbrella partnership REIT, or UPREIT. The Company has elected to be taxed as a REIT under the Internal Revenue Code of 1986, as amended (the Internal Revenue Code). 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 June 30, 2009, the Company had direct and indirect equity interests in 628 operating storage facilities located in 33 states and Washington, D.C. In addition, the Company managed 110 properties for franchisees and third parties, bringing the total number of operating properties which it owns and/or manages to 738.

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. On June 2, 2009, the Company announced the wind-down of its development activities. As of June 30, 2009, there were 22 development projects in process that the Company expects to complete by the third quarter of 2010. 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 are presented on the accrual basis of accounting in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they may not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (including normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and six months ended June 30, 2009 are not necessarily indicative of results that may be expected for the year ended December 31, 2009. The Condensed Consolidated Balance Sheet as of December 31, 2008 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, 2008 and Form 8-K dated June 5, 2009, updating Items 6, 7 and 8 of the Company s Form 10-K for the year ended December 31, 2008, filed with the Securities and Exchange Commission (SEC).

Reclassifications

Certain amounts in the 2008 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.

Revisions to Prior Period Numbers

Effective January 1, 2009, the Company adopted certain recently issued accounting standards that required the Company to retroactively adopt the presentation and disclosure requirements and to restate prior period financial statements as noted in Recently Issued Accounting Standards, below. The Company also revised the amounts allocated to its noncontrolling interests in its Operating Partnership and calculated earnings per share for 2008.

Recently Issued Accounting Standards

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement No. 157, *Fair Value Measurements* (FAS 157). FAS 157 defines fair value, establishes guidelines for measuring fair value and expands disclosures regarding fair value measurement. FAS 157 applies under other accounting pronouncements that require or permit fair value measurements, and does not require any new fair value measurements. FAS 157 was effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. In February 2008, the FASB issued FASB Statement of Position No. 157-2, *Effective Date of FASB Statement No. 157* (the FSP). The FSP amends FAS 157 to delay the effective date for FAS 157 for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis. The Company adopted FAS 157 effective January 1, 2008, except as it related to nonfinancial assets and liabilities. The Company adopted FAS 157 for nonfinancial assets and liabilities effective January 1, 2009.

In December 2007, the FASB issued revised Statement No. 141, *Business Combinations* (FAS 141(R)). FAS 141(R) establishes principles and requirements for how an acquirer in a business combination recognizes and measures in its financial statements the assets acquired and liabilities assumed. Generally, assets acquired and liabilities assumed in a transaction are recorded at the acquisition-date fair value with limited exceptions. FAS 141(R) also changed the accounting treatment and disclosure for certain specific items in a business combination. FAS 141(R) applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first fiscal year beginning on or after December 15, 2008. The Company adopted FAS 141(R) for all acquisitions subsequent to January 1, 2009.

In December 2007, the FASB issued Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements An Amendment of ARB No. 51* (FAS 160). FAS 160 establishes new accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. FAS 160 requires a company to clearly identify and 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. FAS 160 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. As a result of the issuance of FAS 160, the guidance in EITF Topic D-98, *Classification and Measurement of Redeemable Securities* was amended to include redeemable noncontrolling interests within its scope. If noncontrolling interests are determined to be redeemable, they are to be carried at the higher of (a) their carrying value or (b) their redeemable value as of the balance sheet date and reported as temporary equity. FAS 160 requires retroactive adoption of the presentation and disclosure requirements for existing noncontrolling interests, with all other requirements applied prospectively. The Company adopted FAS 160 and related guidance effective January 1, 2009.

In March 2008, the FASB issued Statement No. 161, *Disclosures about Derivative Instruments and Hedging Activities,* an amendment of FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities* (FAS 161). FAS 161 changes the disclosure requirements for derivative instruments and hedging activities. Entities are required to provide enhanced disclosures stating how and why an entity uses derivative instruments; how derivative instruments and related hedged items are accounted for under SFAS No. 133 and its related interpretations; and how derivative instruments and related hedged items affect an entity s financial position, financial performance and cash flows. FAS 161 requires that objectives for using derivative instruments be disclosed in terms of underlying risk and accounting designation. FAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. FAS 161 also encourages but does not require comparative disclosures for earlier periods at initial adoption. The Company adopted FAS 161 effective January 1, 2009. Since FAS 161 only requires additional disclosures concerning derivatives and hedging activities, the adoption of FAS 161 did not have any impact on the Company s net income (loss), cash flows, or financial position.

In May 2008, the FASB issued FASB Statement of Position No. APB 14-1, *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)* (FSP APB 14-1). Under FSP APB 14-1, entities with convertible debt instruments that may be settled entirely or partially in cash upon conversion should separately account for the liability and equity components of the instrument in a manner that reflects the issuer s economic interest cost. The effect of the adoption FSP APB 14-1 on the Company s exchangeable senior notes is that the equity component is included in the paid-in-capital section of stockholders equity on the consolidated balance sheet and the value of the equity component is treated as original issue discount for purposes of accounting for the debt component. The original issue discount is amortized over the period of the debt as additional interest expense. FSP APB 14-1 is effective for fiscal years beginning after December 15, 2008, and for interim periods within those fiscal years, with retrospective application required. The Company adopted FSP APB

14-1 effective January 1, 2009.

In April 2008, the FASB issued FASB Staff Position No. 142-3, *Determination of the Useful Life of Intangible Assets* (FSP FAS 142-3). FSP FAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used in determining the useful life of a recognized intangible asset under Statement of Financial Accounting Standard No. 142, *Goodwill and Other Intangible Assets.* This new guidance applies prospectively to intangible assets

Table of Contents

that are acquired individually or with a group of other assets in business combinations and asset acquisitions. FSP FAS 142-3 is effective for fiscal years beginning after December 31, 2008. The Company adopted FSP FAS 142-3 for all acquisitions subsequent to January 1, 2009.

In June 2008, the FASB issued FASB Staff Position EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities,* (FSP EITF 03-6-1). FSP EITF 03-6-1 provides that unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method as described in FASB Statement of Financial Accounting Standards No. 128, *Earnings per Share.* FSP EITF 03-6-1 is effective for financial statements issued for fiscal years beginning on or after December 15, 2008. The Company adopted FSP EITF 03-6-1 effective January 1, 2009 and has applied this guidance to all periods presented.

In April 2009, the FASB issued FASB Staff Position No. FAS 107-1 and APB 28-1, *Interim Disclosures About Fair Value of Financial Instruments* (FSP 107-1), which amends FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments*, to require disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. In addition, FSP 107-1 amends APB Opinion No. 28, *Interim Financial Reporting*, to require those disclosures in summarized financial information at interim reporting periods. Companies will also be required to disclose the method and significant assumptions used to estimate the fair value of financial instruments and describe any changes in the methods or methodology occurring during the period. FSP 107-1 is effective for interim reporting periods ending after June 15, 2009, with early adoption permitted, but does not require disclosures for earlier periods presented for comparative purposes at adoption. The Company adopted FSP 107-1 effective June 15, 2009 and has applied this guidance to all periods presented. The adoption of FSP 107-1 did not have any impact on the Company s net income (loss), cash flows, or financial position.

In April 2009, the FASB issued FASB Staff Position No. FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* (FSP 157-4), which provides guidance for estimating fair value in accordance with FAS 157 when the volume and level of activity for the asset or liability have significantly decreased and identifying circumstances that may indicate that a transaction is not orderly. FSP 157-4 is effective for interim and annual reporting periods ending after June 15, 2009, with early adoption for periods ending after March 15, 2009 permitted. FSP 115-2 does not require disclosures for earlier periods presented for comparative purposes at adoption. The Company adopted FSP 157-4 effective March 15, 2009 and has applied this guidance to all periods presented. The adoption of FSP 157-4 did not have any impact on the Company s net income (loss), cash flows, or financial position.

In May 2009, the FASB issued Statement of Financial Accounting Standards No. 165, *Subsequent Events* (FAS 165), which provides guidance to establish general standards of accounting for and disclosures of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. FAS 165 also requires entities to disclose the date through which subsequent events were evaluated as well as the rationale for why that date was selected. FAS 165 is effective for interim and annual periods ending after June 15, 2009, and accordingly, the Company adopted this standard during the second quarter of 2009. FAS 165 requires that public entities evaluate subsequent events through the date that the financial statements are issued. The Company has evaluated subsequent events through the time of filing these financial statements with the SEC on August 7, 2009.

In June 2009, the FASB issued Statement of Financial Accounting Standards No. 167, *Amendments to FASB Interpretation No. 46(R),* (FAS 167), which amends guidance in FIN 46(R) for determining whether an entity is a variable interest entity, or VIE, and requires the performance of a qualitative rather than a quantitative analysis to determine the primary beneficiary of a VIE. Under this guidance, an entity would be required to consolidate a VIE if it has (i) the power to direct the activities that most significantly impact the entity s economic performance and (ii) the obligation to absorb losses of the VIE or the right to receive benefits from the VIE that could be significant to the VIE. FAS 167 is effective for the first annual reporting period that begins after November 15, 2009, with early adoption prohibited. The Company is currently evaluating the effect of the adoption of FAS 167 on its financial statements.

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	**June 30, 2009**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Notes payable associated with Swap Agreement	$ (63,492)	$	$ (63,492)	$
Other assets - Swap Agreement	200		200	
Total	$ (63,292)	$	$ (63,292)	$

The Company did not have any significant assets or liabilities that are re-measured on a recurring basis using significant unobservable inputs (Level 3) for the three and six months ended June 30, 2009.

Table of Contents

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. When such an event occurs, the Company compares the carrying value of these long-lived assets to the undiscounted future net operating cash flows attributable to the assets using significant unobservable inputs. An impairment loss is recorded if the net carrying value of the assets exceeds the undiscounted future net operating cash flows attributable to the asset. The impairment loss recognized equals the excess of net carrying value over the related fair value of the asset.

When real estate assets are identified as held for sale, the Company discontinues depreciating the assets and estimates the fair value of the assets, net of selling costs, using significant unobservable inputs. 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 when events or circumstances indicate there may be an impairment. An investment is impaired if the Company s estimate of the fair value of the investment is less than its carrying value using significant unobservable inputs. 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 properties, the assets are valued as tangible and intangible assets and liabilities acquired based on their fair values using significant unobservable inputs. The value of the tangible assets, consisting of land and buildings, are determined as if vacant, that is, at replacement cost. 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 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.

On June 2, 2009, the Company announced the wind-down of its development activities. As a result of this change, the Company reviewed its properties under construction, unimproved land and its investments in development projects for potential impairments. This review included the preparation of updated models based on current market conditions, obtaining appraisals and reviewing recent sales and list prices of undeveloped land and mature self storage facilities. Based on this review, the Company has identified certain assets as being impaired. The impairments relating to long lived assets where the Company intends to complete the development and hold the asset are the result of the estimated future undiscounted cash flows being less than the current carrying value of the assets. The Company compared the carrying value of certain undeveloped land and seven condominiums that the Company intends to sell to the fair market value of similar undeveloped land and condominiums. For the assets that the Company intends to sell, where the current estimated fair market value less costs to sell was below the carrying value, the Company reduced the asset to the current fair market value less selling costs and recorded an impairment charge. The impairments relating to investments in development joint ventures are the result of the Company comparing the estimated current fair market value to the carrying value of the investment. For those investments in development joint ventures where the current estimated fair market value was below the carrying value, the Company reduced the investment to the current fair market value through an impairment charge.

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

		Fair Value Measurements at Reporting Date Using			
Description	June 30, 2009	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Gains (Losses)
Long-lived assets held and used	$ 12,392	$	$	$ 12,392	$ (6,862)
Investments in real estate ventures	9,934			9,934	(2,936)
Real estate assets held for sale included in net real estate assets	11,275			11,275	(9,085)
	$ 33,601	$	$	$ 33,601	$ (18,883)

Table of Contents

3. NET INCOME (LOSS) PER SHARE

Basic earnings per common share is computed by dividing net income (loss) attributable to common stockholders by the weighted average number of common shares outstanding. 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 (CCSs), Contingent Conversion Units (CCUs), 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 (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, or reduce earnings per share, are included.

The Company s Operating Partnership has $95,163 principal amount of exchangeable senior notes issued and outstanding as of June 30, 2009 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, 2009, 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 2009; therefore holders of the exchangeable senior notes may not elect to convert them during the third quarter of 2009.

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 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 were included in the computation at June 30, 2009 or 2008 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 Preferred OP units into common shares, where the Company has the option to redeem in cash or shares as discussed in Note 16 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 paragraph 29 of FAS 128.

For the three months ended June 30, 2009 and 2008, options to purchase 5,698,996 and 547,392 shares of common stock and for the six months ended June 30, 2009 and 2008, 5,773,724 and 561,600 shares of common stock, respectively, were excluded from the computation of earnings per share as their effect would have been anti-dilutive. All unreleased restricted stock grants have been included in basic and diluted shares outstanding as required by EITF 03-6-1 because such shares earn a non-forfeitable dividend and carry voting rights.

Table of Contents

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

	For the Three Months Ended June 30, 2009	2008	For the Six Months Ended June 30, 2009	2008
Net income (loss) attributable to common stockholders	$ (7,541)	$ 6,497	$ 20,078	$ 10,832
Add: Income allocated to noncontrolling interest - Preferred Operating Partnership and Operating Partnership	1,082	1,963	4,473	3,808
Subtract: Fixed component of income allocated to noncontrolling interest - Preferred Operating Partnership	(1,438)	(1,438)	(2,875)	(2,875)
Net income (loss) for diluted computations	$ (7,897)	$ 7,022	$ 21,676	$ 11,765
Weighted average common shares outstanding:				
Average number of common shares outstanding - basic	86,397,618	73,900,524	86,170,270	70,034,123
Operating Partnership units	4,150,040	4,090,771	4,150,040	4,090,771
Preferred Operating Partnership units	989,980	989,980	989,980	989,980
Dilutive and cancelled stock options and CCS/CCU conversions	69,865	591,492	65,126	531,755
Average number of common shares outstanding - diluted	91,607,503	79,572,767	91,375,416	75,646,629
Net income (loss) per common share				
Basic	$ (0.09)	$ 0.09	$ 0.23	$ 0.15
Diluted	$ (0.09)	$ 0.09	$ 0.23	$ 0.15

4. REAL ESTATE ASSETS

The components of real estate assets are summarized as follows:

	June 30, 2009	December 31, 2008
Land - operating	$ 465,244	$ 461,883
Land - development	65,259	64,392
Buildings and improvements	1,577,484	1,555,598
Intangible assets - tenant relationships	33,355	33,234
Intangible lease rights	6,150	6,150
	2,147,492	2,121,257
Less: accumulated depreciation and amortization	(207,260)	(182,335)
Net operating real estate assets	1,940,232	1,938,922
Real estate under development	89,310	58,734
Net real estate assets	$ 2,029,542	$ 1,997,656
Real estate assets held for sale included in net real estate assets	$ 11,275	$

Real estate assets held for sale include five parcels of vacant land and seven condominiums currently under construction.

On April 10, 2009, the Company sold vacant land in Los Angeles, California for cash of $4,652. A loss of $343 was recorded as a result of this sale, and is included in unrecovered development and acquisition costs.

Table of Contents

5. PROPERTY ACQUISITIONS

The following table shows the Company s acquisitions of operating properties for the six months ended June 30, 2009, and does not include purchases of raw land or improvements made to existing assets:

			Consideration Paid			Acquisition Date Fair Value				
Property Location	Number of Properties	Date of Acquisition	Total Paid	Cash Paid	Net Liabilities/ (Assets) Assumed	Land	Building	Intangible	Closing costs - expensed	Source of Acquisition
Virginia	1	1/23/2009	$ 7,425	$ 7,438	$ (13)	2,076	5,175	122	52	Unrelated franchisee

Under FAS 141(R), the Company treats property acquisitions as businesses and records the assets and the liabilities at their fair values as of the acquisition date. Acquisition-related transaction costs are expensed as incurred.

6. INVESTMENTS IN REAL ESTATE VENTURES

Investments in real estate ventures consisted of the following:

	Equity Ownership %	Excess Profit Participation %	Investment balance at June 30, 2009	Investment balance at December 31, 2008
Extra Space West One LLC (ESW)	5%	40%	$ 1,305	$ 1,492
Extra Space West Two LLC (ESW II)	5%	40%	4,814	4,874
Extra Space Northern Properties Six, LLC (ESNPS)	10%	35%	1,451	1,482
Extra Space of Santa Monica LLC (ESSM)	41%	41%	2,532	3,225
Clarendon Storage Associates Limited Partnership (Clarendon)	50%	50%	3,239	3,318
PRISA Self Storage LLC (PRISA)	2%	17%	12,073	12,460
PRISA II Self Storage LLC (PRISA II)	2%	17%	10,350	10,431
PRISA III Self Storage LLC (PRISA III)	5%	20%	3,968	4,118
VRS Self Storage LLC (VRS)	45%	9%	46,410	47,488
WCOT Self Storage LLC (WCOT)	5%	20%	5,122	5,229
Storage Portfolio I, LLC (SP I)	25%	40%	16,913	17,471
Storage Portfolio Bravo II (SPB II)	20%	25-45%	13,925	14,168
U-Storage de Mexico S.A. and related entities (U-Storage)	35-40%	35-40%	7,379	9,205
Other minority owned properties	10-50%	10-50%	2,791	1,830
			$ 132,272	$ 136,791

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.

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

	Three months ended June 30,		Six months ended June 30,	
	2009	**2008**	**2009**	**2008**
Equity in earnings of ESW	$ 275	$ 371	$ 584	$ 693
Equity in earnings (losses) of ESW II	(6)	(21)	(10)	(38)
Equity in earnings of ESNPS	49	64	96	119
Equity in earnings of Clarendon	89	98	184	189
Equity in earnings (losses) of PRISA	(20)	169	147	346
Equity in earnings of PRISA II	140	148	277	296
Equity in earnings of PRISA III	59	55	116	126
Equity in earnings of VRS	527	67	1,052	131
Equity in earnings of WCOT	61	72	129	147
Equity in earnings of SP I	230	293	465	553
Equity in earnings of SPB II	108	149	234	321
Equity in earnings (losses) of U-Storage	(1)	(43)	9	(116)
Equity in earnings (losses) of other minority owned properties	130	(49)	253	(172)
	$ 1,641	$ 1,373	$ 3,536	$ 2,595

Equity in earnings (losses) of ESW II, SP I and SPB II include the amortization of the Company s excess purchase price of $25,713 of these equity investments over its original basis. The excess basis is amortized over 40 years.

Table of Contents

Variable Interests in Unconsolidated Real Estate Joint Ventures:

The Company has interests in two unconsolidated joint ventures with unrelated third parties (Montrose and Eastern Avenue) which are variable interest entities (VIEs). The Company holds a 10% equity interest in Montrose and Eastern Avenue, but has 50% of the voting rights. Qualification as a VIE was based on the disproportionate voting and ownership percentages. The Company performed a probability-based cash flow analysis for each of these joint ventures to determine which party was the primary beneficiary of these VIEs. These analyses were performed using the Company s best estimates of the future cash flows based on its historical experience with numerous similar assets. As a result of these analyses, the Company determined that it was not the primary beneficiary of either Montrose or Eastern Avenue as the Company does not receive a majority of either joint venture s expected residual returns or bear a majority of the expected losses. Accordingly, these interests are carried on the equity method.

Both Montrose and Eastern Avenue each own a single pre-stabilized self-storage property. The 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 for working capital. The payables to the Company are generally amounts owed for expenses paid on behalf of the joint ventures by the Company as manager. The Company performs management services for both the Montrose and Eastern Avenue joint ventures in exchange for a management fee of approximately 6% of cash collected by the properties. The Company s joint venture partners can replace the Company as manager of the properties upon written notice. The Company has not provided financial or other support during the periods presented to Montrose or Eastern Avenue that it was not previously contractually obligated to provide.

As of June 30, 2009, there were no amounts for Montrose and Eastern Avenue included in Investments in Real Estate on the Company s consolidated balance sheet. No liability was recorded associated with the Company s guarantee of the construction loans of Montrose or Eastern Avenue. The Company s maximum exposure to loss for each joint venture as of June 30, 2009 is the total of the guaranteed loan balance, the payables due to the Company and the Company s investment balances in each joint venture. The Company believes that the risk of incurring a loss as a result of having to perform on the guarantee is remote and therefore no liability has been recorded. Also, repossessing and/or selling the self-storage facilities 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 liability balances and the maximum exposure to loss related to Montrose and Eastern Avenue as of June 30, 2009:

	Liability Balance	Investment balance	Balance of Guaranteed loan	Payables to Company	Maximum exposure to loss	Difference
Eastern Avenue	$	$	$ 5,484	$ 1,697	$ 7,181	$ (7,181)
Montrose			7,295	1,385	8,680	(8,680)
	$	$	$ 12,779	$ 3,082	$ 15,861	$ (15,861)

Variable Interests in Consolidated Real Estate Joint Ventures

The Company has variable interests in four consolidated joint ventures with third parties (the VIE JVs) which are VIEs. The VIE JVs 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 for working capital. The payables to the Company are generally amounts owed for expenses paid on behalf of the joint ventures by the Company as manager. The Company owns 50% to 72% of the common equity interests in the VIE JVs. The Company performed probability-based cash flow projections for each venture using the Company s best estimates of future revenues and expenses based on historical experience with numerous similar assets. According to these analyses, the joint ventures were determined to be VIEs based on an assessment that the equity financing was inadequate to support operations. The Company was also determined to be the primary beneficiary of each of the VIE JVs, as it receives the majority of the benefits and bears the majority of the expected losses of each as a result of its majority ownership and the management agreements. Therefore, each of the VIE JVs are consolidated with the assets and liabilities of each joint venture included in the Company s consolidated financial statements, with intercompany balances and transactions eliminated.

In January 2009, the Company purchased a lender s interest in a construction loan to a joint venture that owns a single property located in Sacramento, CA. The construction loan was to ESS of Sacramento One LLC, a joint venture in which the Company owns a 50% interest. This joint venture was not consolidated and was not considered a VIE JV as of December 31, 2008. The Company considers the purchase of this loan to be a reconsideration event and now considers ESS of Sacramento One LLC to be a VIE JV and has determined that the Company now bears the majority of the risk of loss. As a result of this

Table of Contents

loan purchase by the Company, the joint venture is now consolidated. The assets and liabilities were recorded at fair value as required by FAS 141(R).

The Company performs development services for Washington Ave. and ESS of Plantation LLC in exchange for a development fee of 2% and 1% of budgeted costs, respectively. The Company performs management services for ESS of Sacramento One LLC and Franklin Blvd. in exchange for a management fee of approximately 6% of cash collected by the properties.

The table below illustrates the financing of each of the VIE JVs as well as the carrying amounts of the related assets and liabilities as of June 30, 2009:

Joint Venture	Equity Ownership %	Excess Profit Participation %	Total Assets	Notes Payable	Payables to Company (eliminated)	Payables and Other Liabilities	Company s Equity (eliminated)	JV Partners Equity (non-controlling interest)
ESS of Sacramento One LLC	50%	50%	$ 10,364	$ 5,000	$ 5,247	$ 49	$ (516)	$ 584
Franklin Blvd.	50%	50%	7,098	5,149	1,987	84	(61)	(61)
Washington Ave.	50%	50%	9,597	4,457	2,875	731	767	767
ESS of Plantation LLC	72%	40%	2,087		6	49	1,472	560
			$ 29,146	$ 14,606	$ 10,115	$ 913	$ 1,662	$ 1,850

Except as disclosed above, the Company has not provided financial or other support during the periods presented to these VIEs that it was not previously contractually obligated to provide. The Company has guaranteed the notes payable for these VIEs. The notes payable are secured by the related self-storage properties and are non-recourse. If the joint ventures default on the loans, the Company may be forced to repay its portion of the balance owed. However, repossessing and/or selling the self-storage facilities and land that collateralize the loans could provide funds sufficient to reimburse the Company, and the Company believes that the risk of incurring a loss as a result of having to perform on the guarantees is remote.

7. OTHER ASSETS

The components of other assets are summarized as follows:

	June 30, 2009	December 31, 2008
Equipment and fixtures	$ 11,146	$ 10,671
Less: accumulated depreciation	(8,141)	(7,309)
Other intangible assets	3,296	3,296
Deferred financing costs, net	13,321	12,330
Prepaid expenses and deposits	6,578	5,828
Accounts receivable, net	9,493	11,120

Fair value of interest rate swaps		200		647
Investments in Trusts		3,590		3,590
Deferred tax asset		3,003		2,403
	$	42,486	$	42,576

Table of Contents

8. NOTES PAYABLE

The components of notes payable are summarized as follows:

	June 30, 2009	December 31, 2008
Fixed Rate		
Mortgage and construction loans with banks (includling loans subject to interest rate swaps) bearing interest at fixed rates between 4.65% and 7.30%. 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 August 2009 and April 2019.	$ 949,960	$ 818,166
Variable Rate		
Mortgage and construction loans with banks bearing floating interest rates (including loans subject to reverse interest rate swaps) based on LIBOR and Prime. Interest rates based on LIBOR are between LIBOR plus 1.45% (1.76% and 1.89% at June 30, 2009 and December 31, 2008, respectively) and LIBOR plus 3.25% (3.56% and 3.69% at June 30, 2009 and December 31, 2008, respectively). Interest rates based on Prime are at Prime plus 1.50% (4.75% and 4.75% at June 30, 2009 and December 31, 2008, 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 2009 and May 2014.	115,542	125,432
	$ 1,065,502	$ 943,598

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, 2009.

9. DERIVATIVES

FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities, as amended* (FAS 133) 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 operation.

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 Company s fixed and variable-rate borrowings. In accordance with FAS 133, 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.

In October 2004, the Company entered into a reverse interest rate swap agreement (Reverse Swap Agreement) to float $61,770 of 4.30% fixed interest rate. The Company entered into the Reverse Swap Agreement to hedge the risk of changes in the fair value of the related debt attributed to changes in interest rates. The Reverse Swap Agreement allowed fluctuations in the fair value of the debt to be offset by the value of the interest rate swap. The fair value of the Swap Agreement was determined through observable prices in active markets for identical agreements. Under this Reverse Swap Agreement, the Company received interest at a fixed rate of 4.30% and paid interest at a variable rate equal to LIBOR plus 0.65%. The Reverse Swap Agreement expired on June 1, 2009.

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

	Classification of Income	Three months ended June 30,		Six months ended June 30,	
Type	**(Expense)**	**2009**	**2008**	**2009**	**2008**
Reverse Swap Agreement (fair value hedge)	Interest expense	$ 495	$ 119	$ 916	$ 7
Swap Agreement (cash flow hedge)	Interest expense	(244)		(244)	
		$ 251	$ 119	$ 672	$ 7

Table of Contents

On June 30, 2008, the Company entered into a loan agreement in the amount of $64,530 secured by certain properties. The loan bears interest at LIBOR plus 2.0%, maturing on June 30, 2011. The loan agreement has a two year extension, at the option of the Company, which would extend the loan maturity to June 30, 2013. On January 28, 2009, the Company entered into an interest rate swap agreement (Swap Agreement) with an effective date of February 1, 2009 and a maturity date of June 30, 2013. Under the Swap Agreement, the Company will receive interest at a variable rate of LIBOR plus 2.0% and pay interest at a fixed rate of 4.24%. The Company entered into the Swap Agreement to hedge the risk of changes in interest rate payments attributed to changes in the LIBOR rate. The other critical terms of the Swap Agreement are identical to those of the underlying debt. This Swap Agreement is a cash flow hedge, as defined by FAS 133, and the effective portion of the gain or loss on the Swap Agreement will be reported as a component of other comprehensive income and reclassified into interest expense when the forecasted transaction affects earnings. Information relating to the gain recognized relating to the Swap Agreement is as follows:

Type		Gain/(loss) recognized in OCI Six months ended June 30, 2009	Location of amounts reclassified from OCI into income		Gain/(loss) reclassified from OCI Six months ended June 30, 2009
Swap Agreement (cash flow hedge)	$	200	Interest expense	$	

The Swap Agreement was highly effective for the three and six months ended June 30, 2009.

The balance sheet classification and carrying amounts of the Reverse Swap Agreement and the Swap Agreement are as follows:

	Asset/(Liability) Derivatives					
	June 30, 2009			December 31, 2008		
Derivatives designated as hedging instruments under FAS 133:	Balance Sheet Location		Fair Value	Balance Sheet Location		Fair Value
Reverse Swap Agreement (expired 6/1/2009)	n/a	$		Other assets	$	647
Swap Agreement	Other assets		200	n/a		
		$	200		$	647

10. 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 $40,000 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 $1,238. On July 27, 2005, the proceeds from the sale of the preferred and common securities of $41,238 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 $41,000 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 $1,269. On May 24, 2005, the proceeds from the sale of the preferred and common securities of $42,269 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.

Table of Contents

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 $35,000 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 $1,083. On April 8, 2005, the proceeds from the sale of the trust preferred and common securities of $36,083 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 FASB Interpretation No. 46R, *Consolidation of Variable Interest Entities* (FIN 46R), which addresses the consolidation of VIEs. Under FIN 46R, Trust, Trust II and Trust III are VIEs because the holders of the equity investment at risk (the trust preferred securities) do not have adequate decision making ability over the trusts activities 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 as discussed above for the proceeds, which are owed to the Trust, Trust II and Trust III by the Company. The Company has also recorded its investment in the trusts common securities as other assets.

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. Following is a tabular comparison of the liabilities the Company has recorded as a result of its involvements with the trusts to the maximum exposure to loss the Company is subject to related to the trusts as of June 30, 2009:

	Notes payable to Trusts as of June 30, 2009	Maximum exposure to loss	Difference
Trust	$ 36,083	$ 35,000	$ 1,083
Trust II	42,269	41,000	1,269
Trust III	41,238	40,000	1,238
	$ 119,590	$ 116,000	$ 3,590

As noted above, these differences represent the amounts that the trusts would repay the Company for its investment in the trusts common securities.

11. EXCHANGEABLE SENIOR NOTES

On March 27, 2007, our Operating Partnership issued $250,000 of its 3.625% Exchangeable Senior Notes due April 1, 2027 (the Notes). Costs incurred to issue the Notes were approximately $5,700. These costs are being amortized 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, 2009. 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 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 exchange rate of approximately 43.1091 shares per one thousand dollars 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

Table of Contents

considered Events of Default, as defined in the indenture governing the Notes, which may result in the accelerated maturity of the Notes.

Adoption of FSP APB 14-1

In May 2008, the FASB issued FSP ABP 14-1. Under FSP APB 14-1, entities with convertible debt instruments that may be settled entirely or partially in cash upon conversion should separately account for the liability and equity components of the instrument in a manner that reflects the issuer s economic interest cost. The Company retroactively adopted FSP APB 14-1 effective January 1, 2009. As a result, the liability and equity components of the Notes are now accounted for separately. The equity component is included in the paid-in-capital section of stockholders equity on the condensed consolidated balance sheet, and the value of the equity component is treated as original issue discount for purposes of accounting for the debt component. The discount is being amortized over the period of the debt as additional interest expense.

Information about the carrying amounts of the equity component, the principal amount of the liability component, its unamortized discount, and its net carrying amount are as follows:

	June 30, 2009	December 31, 2008
Carrying amount of equity component	$ 19,726	$ 21,779
Principal amount of liability component	$ 95,163	$ 209,663
Unamortized discount	(5,070)	(13,031)
Net carrying amount of liability component	$ 90,093	$ 196,632

The discount will be amortized over the remaining period of the debt through its first redemption date (April 1, 2012). The effective interest rate on the liability component is 5.75%. The amount of interest cost recognized relating to the contractual interest rate and the amortization of the discount on the liability component is as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Contractual interest	$ 1,135	$ 2,266	$ 2,853	$ 4,531
Amortization of discount	563	1,059	1,404	2,088
Total interest expense recognized	$ 1,698	$ 3,325	$ 4,257	$ 6,619

Repurchases of Notes

During May 2009, the Company repurchased $43,000 principal amount of Notes. The Company paid cash of $36,340 to repurchase the Notes, exclusive of $268 paid for interest accrued on the repurchased Notes through the date of repurchase.

During March 2009, the Company repurchased $71,500 principal amount of Notes. The Company paid cash of $44,513 to repurchase the Notes, exclusive of $1,136 paid for interest accrued on the repurchased Notes through the date of repurchase.

During October 2008, the Company repurchased $40,337 principal amount of Notes. The Company paid cash of $31,721 to repurchase the Notes, exclusive of $35 paid for interest accrued on the repurchased Notes through the date of repurchase.

FSP APB 14-1 requires that the value of the consideration paid to repurchase the Notes be allocated (1) to the extinguishment of the liability component and (2) the reacquisition of the equity component. The amount allocated to the extinguishment of the liability component is equal to the fair value of that component immediately prior to extinguishment. The difference between the consideration attributed to the extinguishment of the liability component and the sum of (a) the net carrying amount of the repurchased liability component, and (b) the related unamortized debt issuance costs is recognized as a gain on debt extinguishment. The remaining settlement consideration is allocated to the reacquisition of the equity component of the repurchased Notes, and recognized as a reduction of stockholders equity.

Table of Contents

Information on the repurchases and the related gains is as follows:

	May 2009	March 2009	October 2008 (As revised see Note 2)
Principal amount repurchased	$ 43,000	$ 71,500	$ 40,337
Amount allocated to:			
Extinguishment of liability component	$ 35,000	$ 43,800	$ 30,696
Reacquisition of equity component	1,340	713	1,025
Total cash paid for repurchase	$ 36,340	$ 44,513	$ 31,721
Exchangeable senior notes repurchased	$ 43,000	$ 71,500	$ 40,337
Extinguishment of liability component	(35,000)	(43,800)	(30,696)
Discount on exchangeable senior notes	(2,349)	(4,208)	(2,683)
Related debt issuance costs	(558)	(1,009)	(646)
Gain on repurchase	$ 5,093	$ 22,483	$ 6,312

12. LINES OF CREDIT

On October 19, 2007, the Operating Partnership entered into a $100,000 revolving line of credit (the Credit Line) that matures October 31, 2010 with two one-year extensions available. The Company intends to use the proceeds of the Credit Line to repay debt and for general corporate purposes. The Credit Line has an interest rate of between 100 and 205 basis points over LIBOR, depending on certain financial ratios of the Company (1.31% at June 30, 2009). The Credit Line is collateralized by mortgages on certain real estate assets. As of June 30, 2009, the Credit Line had $100,000 of capacity based on the assets collateralizing the Credit Line. $100,000 and $27,000 was drawn on the Credit Line as of June 30, 2009 and December 31, 2008, respectively. The Company is subject to certain restrictive covenants relating to the Credit Line. The Company was in compliance with all covenants as of June 30, 2009.

On February 13, 2009, the Company entered into a $50,000 revolving secured line of credit (the Secondary Credit Line) that is collateralized by mortgages on certain real estate assets and matures on February 13, 2012. The Company intends to use the proceeds of the Secondary Credit Line to repay debt and for general corporate purposes. The Secondary Credit Line has an interest rate of LIBOR plus 325 basis points (3.56% at June 30, 2009). As of June 30, 2009, there were no amounts drawn on the Secondary Credit Line. The Company is subject to certain restrictive covenants relating to the Secondary Credit Line. The Company was in compliance with all covenants as of June 30, 2009.

13. OTHER LIABILTIES

The components of other liabilities are summarized as follows:

	June 30, 2009	December 31, 2008
Deferred rental income	$ 12,823	$ 12,535
Lease obligation liability	6,805	3,029

Income taxes payable		364		2,825
Other miscellaneous liabilities		6,831		3,878
	$	26,823	$	22,267

14. RELATED PARTY AND AFFILIATED REAL ESTATE JOINT VENTURE TRANSACTIONS

The Company provides management and development services to certain joint ventures, franchises, third parties and other related party properties. Management agreements provide generally for management fees of 6% of cash collected from properties for the management of operations at the self-storage facilities.

Table of Contents

Management fee revenues for related parties and affiliated real estate joint ventures are summarized as follows:

		For the Three Months ended June 30,		For the Six Months ended June 30,	
Entity	**Type**	**2009**	**2008**	**2009**	**2008**
ESW	Affiliated real estate joint ventures	$ 99	$ 110	$ 202	$ 218
ESW II					