

Extra Space Storage Inc.  
Form 10-Q  
November 06, 2014  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**

**FORM 10-Q**

(Mark One)

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

**For the quarterly period ended September 30, 2014**

**or**

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

**For the transition period from                      to                      .**

**Commission File Number: 001-32269**

**EXTRA SPACE STORAGE INC.**

**(Exact name of registrant as specified in its charter)**

**Maryland**  
**(State or other jurisdiction of**  
**incorporation or organization)**  
**2795 East Cottonwood Parkway, Suite 400**  
**Salt Lake City, Utah 84121**  
**(Address of principal executive offices)**

**20-1076777**  
**(I.R.S. Employer**  
**Identification No.)**

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

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

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

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

Large accelerated filer ☒ Accelerated filer ☐

Non-accelerated filer ☐ (Do not check if a smaller reporting company) Smaller reporting company ☐

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

**The number of shares outstanding of the registrant's common stock, par value \$0.01 per share, as of October 31, 2014, was 116,330,711.**

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**EXTRA SPACE STORAGE INC.**

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**STATEMENT ON FORWARD-LOOKING INFORMATION**

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

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

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

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

failure to close pending acquisitions on expected terms, or at all;

the effect of competition from new and existing 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 ), tenant reinsurance and other aspects of our business, which could adversely affect our results;

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disruptions in credit and financial markets and resulting difficulties in raising capital or obtaining credit at reasonable rates or at all, which could impede our ability to grow;

increased interest rates and operating costs;

reductions in asset valuations and related impairment charges;

the failure of our joint venture partners to fulfill their obligations to us or their pursuit of actions that are inconsistent with our objectives;

the failure to maintain our REIT status for federal income tax purposes;

economic uncertainty due to the impact of war or terrorism, which could adversely affect our business plan; and

difficulties in our ability to attract and retain qualified personnel and management members.

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

(amounts in thousands, except share data)

|                                                                                                                                                                                    | <b>September 30, 2014</b><br>(Unaudited) | <b>December 31, 2013</b> |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------|--------------------------|
| <b>Assets:</b>                                                                                                                                                                     |                                          |                          |
| Real estate assets, net                                                                                                                                                            | \$ 3,954,759                             | \$ 3,636,544             |
| Investments in unconsolidated real estate ventures                                                                                                                                 | 86,232                                   | 88,125                   |
| Cash and cash equivalents                                                                                                                                                          | 49,216                                   | 126,723                  |
| Restricted cash                                                                                                                                                                    | 26,205                                   | 21,451                   |
| Receivables from related parties and affiliated real estate joint ventures                                                                                                         | 12,283                                   | 7,542                    |
| Other assets, net                                                                                                                                                                  | 97,200                                   | 96,755                   |
| Total assets                                                                                                                                                                       | \$ 4,225,895                             | \$ 3,977,140             |
| <b>Liabilities, Noncontrolling Interests and Equity:</b>                                                                                                                           |                                          |                          |
| Notes payable                                                                                                                                                                      | \$ 1,779,201                             | \$ 1,588,596             |
| Premium on notes payable                                                                                                                                                           | 4,010                                    | 4,948                    |
| Exchangeable senior notes                                                                                                                                                          | 250,000                                  | 250,000                  |
| Discount on exchangeable senior notes                                                                                                                                              | (13,920)                                 | (16,487)                 |
| Notes payable to trusts                                                                                                                                                            | 119,590                                  | 119,590                  |
| Lines of credit                                                                                                                                                                    | 40,000                                   |                          |
| Accounts payable and accrued expenses                                                                                                                                              | 73,528                                   | 60,601                   |
| Other liabilities                                                                                                                                                                  | 39,888                                   | 37,997                   |
| Total liabilities                                                                                                                                                                  | 2,292,297                                | 2,045,245                |
| <b>Commitments and contingencies</b>                                                                                                                                               |                                          |                          |
| <b>Noncontrolling Interests and Equity:</b>                                                                                                                                        |                                          |                          |
| Extra Space Storage Inc. stockholders' equity:                                                                                                                                     |                                          |                          |
| Preferred stock, \$0.01 par value, 50,000,000 shares authorized, no shares issued or outstanding                                                                                   |                                          |                          |
| Common stock, \$0.01 par value, 500,000,000 shares authorized, 116,033,989 and 115,755,527 shares issued and outstanding at September 30, 2014 and December 31, 2013, respectively |                                          |                          |
|                                                                                                                                                                                    | 1,160                                    | 1,157                    |
| Paid-in capital                                                                                                                                                                    | 1,982,612                                | 1,973,159                |
| Accumulated other comprehensive income                                                                                                                                             | 3,735                                    | 10,156                   |

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|                                                                                                                |              |              |
|----------------------------------------------------------------------------------------------------------------|--------------|--------------|
| Accumulated deficit                                                                                            | (248,179)    | (226,002)    |
| Total Extra Space Storage Inc. stockholders' equity                                                            | 1,739,328    | 1,758,470    |
| Noncontrolling interest represented by Preferred Operating Partnership units, net of \$100,000 note receivable | 102,818      | 80,947       |
| Noncontrolling interests in Operating Partnership                                                              | 90,420       | 91,453       |
| Other noncontrolling interests                                                                                 | 1,032        | 1,025        |
| Total noncontrolling interests and equity                                                                      | 1,933,598    | 1,931,895    |
| Total liabilities, noncontrolling interests and equity                                                         | \$ 4,225,895 | \$ 3,977,140 |

See accompanying notes to unaudited condensed consolidated financial statements.

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

(amounts in thousands, except share data)

(unaudited)

|                                                                                                                      | <b>For the Three Months Ended<br/>September 30,</b> |             | <b>For the Nine Months Ended<br/>September 30,</b> |             |
|----------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------|-------------|----------------------------------------------------|-------------|
|                                                                                                                      | <b>2014</b>                                         | <b>2013</b> | <b>2014</b>                                        | <b>2013</b> |
| <b>Revenues:</b>                                                                                                     |                                                     |             |                                                    |             |
| Property rental                                                                                                      | \$ 144,669                                          | \$ 113,881  | \$ 415,448                                         | \$ 324,144  |
| Tenant reinsurance                                                                                                   | 15,385                                              | 12,294      | 43,356                                             | 34,625      |
| Management fees                                                                                                      | 7,314                                               | 6,936       | 20,984                                             | 19,910      |
| Total revenues                                                                                                       | 167,368                                             | 133,111     | 479,788                                            | 378,679     |
| <b>Expenses:</b>                                                                                                     |                                                     |             |                                                    |             |
| Property operations                                                                                                  | 43,294                                              | 34,376      | 129,070                                            | 102,275     |
| Tenant reinsurance                                                                                                   | 2,930                                               | 2,873       | 8,133                                              | 6,985       |
| Acquisition related costs                                                                                            | 436                                                 | 2,427       | 3,885                                              | 3,562       |
| General and administrative                                                                                           | 13,966                                              | 13,943      | 44,253                                             | 40,451      |
| Depreciation and amortization                                                                                        | 29,249                                              | 23,428      | 85,895                                             | 69,238      |
| Total expenses                                                                                                       | 89,875                                              | 77,047      | 271,236                                            | 222,511     |
| Income from operations                                                                                               | 77,493                                              | 56,064      | 208,552                                            | 156,168     |
| Gain (loss) on sale of real estate and<br>earnout from prior acquisitions                                            | (2,500)                                             |             | (10,285)                                           | 800         |
| Loss on extinguishment of debt related<br>to portfolio acquisition                                                   |                                                     | (9,153)     |                                                    | (9,153)     |
| Interest expense                                                                                                     | (20,681)                                            | (16,264)    | (60,937)                                           | (51,992)    |
| Non-cash interest expense related to<br>amortization of discount on equity<br>component of exchangeable senior notes | (679)                                               | (834)       | (2,004)                                            | (947)       |
| Interest income                                                                                                      | 186                                                 | 202         | 1,167                                              | 519         |
| Interest income on note receivable from<br>Preferred Operating Partnership unit<br>holder                            | 1,213                                               | 1,213       | 3,638                                              | 3,638       |
| Income before equity in earnings of<br>unconsolidated real estate ventures and<br>income tax expense                 | 55,032                                              | 31,228      | 140,131                                            | 99,033      |



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|                                                                                                                 |                  |                  |                   |                  |
|-----------------------------------------------------------------------------------------------------------------|------------------|------------------|-------------------|------------------|
| Equity in earnings of unconsolidated real estate ventures                                                       | 2,777            | 3,405            | 7,800             | 8,942            |
| Equity in earnings of unconsolidated real estate ventures gain on purchase of joint venture partners' interests | 378              |                  | 3,816             | 2,556            |
| Income tax (expense) benefit                                                                                    | 1,006            | (2,281)          | (5,337)           | (7,147)          |
| <b>Net income</b>                                                                                               | <b>59,193</b>    | <b>32,352</b>    | <b>146,410</b>    | <b>103,384</b>   |
| Net income allocated to Preferred Operating Partnership noncontrolling interests                                | (2,977)          | (2,033)          | (8,281)           | (5,495)          |
| Net income allocated to Operating Partnership and other noncontrolling interests                                | (1,988)          | (1,074)          | (4,896)           | (2,753)          |
| <b>Net income attributable to common stockholders</b>                                                           | <b>\$ 54,228</b> | <b>\$ 29,245</b> | <b>\$ 133,233</b> | <b>\$ 95,136</b> |
| Earnings per common share                                                                                       |                  |                  |                   |                  |
| Basic                                                                                                           | \$ 0.47          | \$ 0.26          | \$ 1.15           | \$ 0.86          |
| Diluted                                                                                                         | \$ 0.47          | \$ 0.26          | \$ 1.15           | \$ 0.85          |
| Weighted average number of shares                                                                               |                  |                  |                   |                  |
| Basic                                                                                                           | 115,726,911      | 110,827,793      | 115,606,845       | 110,624,757      |
| Diluted                                                                                                         | 121,617,554      | 115,477,145      | 121,551,889       | 115,323,059      |
| Cash dividends paid per common share                                                                            | \$ 0.47          | \$ 0.40          | \$ 1.34           | \$ 1.05          |

See accompanying notes to unaudited condensed consolidated financial statements.

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**Extra Space Storage Inc.**

**Condensed Consolidated Statements of Comprehensive Income**

(amounts in thousands)

(unaudited)

|                                                                     | <b>For the Three Months Ended</b> |             | <b>For the Nine Months Ended</b> |             |
|---------------------------------------------------------------------|-----------------------------------|-------------|----------------------------------|-------------|
|                                                                     | <b>September 30,</b>              |             | <b>September 30,</b>             |             |
|                                                                     | <b>2014</b>                       | <b>2013</b> | <b>2014</b>                      | <b>2013</b> |
| <b>Net income</b>                                                   | \$ 59,193                         | \$ 32,352   | \$ 146,410                       | \$ 103,384  |
| <b>Other comprehensive income (loss):</b>                           |                                   |             |                                  |             |
| Change in fair value of interest rate swaps                         | 1,834                             | (2,073)     | (6,614)                          | 17,967      |
| Total comprehensive income                                          | 61,027                            | 30,279      | 139,796                          | 121,351     |
| Less: comprehensive income attributable to noncontrolling interests | 5,137                             | 2,996       | 12,984                           | 8,796       |
| <b>Comprehensive income attributable to common stockholders</b>     | \$ 55,890                         | \$ 27,283   | \$ 126,812                       | \$ 112,555  |

See accompanying notes to unaudited condensed consolidated financial statements.

(unaudited)

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|                                                  |           |           |           |           |          |             |          |              |          |              |           |      |
|--------------------------------------------------|-----------|-----------|-----------|-----------|----------|-------------|----------|--------------|----------|--------------|-----------|------|
| and<br>option<br>ses                             |           |           |           |           |          |             |          |              |          |              |           |      |
| utions to<br>ing<br>rship<br>eld by<br>ntrolling |           |           |           |           |          |             |          |              |          |              |           |      |
| ts                                               | (5,639)   | (1,758)   | (1,094)   | (5,765)   |          |             |          |              |          |              |           | (14  |
| nds paid<br>nmon<br>t \$1.34<br>re               |           |           |           |           |          |             |          |              |          |              | (155,410) | (155 |
| ces at<br>nber 30,                               | \$ 29,956 | \$ 41,902 | \$ 30,960 | \$ 90,420 | \$ 1,032 | 116,033,989 | \$ 1,160 | \$ 1,982,612 | \$ 3,735 | \$ (248,179) | \$ 1,933  |      |

See accompanying notes to unaudited condensed consolidated financial statements.

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

(amounts in thousands)

(unaudited)

|                                                                                                                | <b>For the Nine Months Ended September 30,</b> |             |
|----------------------------------------------------------------------------------------------------------------|------------------------------------------------|-------------|
|                                                                                                                | <b>2014</b>                                    | <b>2013</b> |
| <b>Cash flows from operating activities:</b>                                                                   |                                                |             |
| Net income                                                                                                     | \$ 146,410                                     | \$ 103,384  |
| Adjustments to reconcile net income to net cash provided by operating activities:                              |                                                |             |
| Depreciation and amortization                                                                                  | 85,895                                         | 69,238      |
| Amortization of deferred financing costs                                                                       | 4,955                                          | 4,198       |
| Loss on earnout related to prior acquisition                                                                   | 2,500                                          |             |
| Loss on extinguishment of debt related to portfolio acquisition                                                |                                                | 9,153       |
| Non-cash interest expense related to amortization of discount on equity component of exchangeable senior notes | 2,004                                          | 947         |
| Non-cash interest benefit related to amortization of premium on notes payable                                  | (2,350)                                        | (983)       |
| Compensation expense related to stock-based awards                                                             | 3,855                                          | 3,654       |
| Gain on purchase of joint venture partners' interests                                                          | (3,438)                                        | (2,556)     |
| Distributions from unconsolidated real estate ventures in excess of earnings                                   | 3,989                                          | 3,538       |
| Changes in operating assets and liabilities:                                                                   |                                                |             |
| Receivables from related parties and affiliated real estate joint ventures                                     | (434)                                          | 891         |
| Other assets                                                                                                   | 467                                            | (1,303)     |
| Accounts payable and accrued expenses                                                                          | 12,927                                         | 5,949       |
| Other liabilities                                                                                              | (216)                                          | 2,474       |
| Net cash provided by operating activities                                                                      | 256,564                                        | 198,584     |
| <b>Cash flows from investing activities:</b>                                                                   |                                                |             |
| Acquisition of real estate assets                                                                              | (328,235)                                      | (82,949)    |
| Development and redevelopment of real estate assets                                                            | (11,288)                                       | (3,941)     |
| Proceeds from sale of real estate assets                                                                       |                                                | 889         |
| Investments in unconsolidated real estate ventures                                                             |                                                | (1,126)     |
| Change in restricted cash                                                                                      | (4,754)                                        | (5,827)     |
| Purchase of notes receivable                                                                                   | (9,028)                                        |             |
| Issuance of notes receivable                                                                                   |                                                | (5,000)     |
| Purchase of equipment and fixtures                                                                             | (3,636)                                        | (2,349)     |
| Net cash used in investing activities                                                                          | (356,941)                                      | (100,303)   |

|                                                                           |           |           |
|---------------------------------------------------------------------------|-----------|-----------|
| <b>Cash flows from financing activities:</b>                              |           |           |
| Net proceeds from the issuance of exchangeable senior notes               |           | 246,250   |
| Proceeds from notes payable and lines of credit                           | 505,957   | 364,855   |
| Principal payments on notes payable and lines of credit                   | (312,287) | (532,348) |
| Deferred financing costs                                                  | (3,851)   | (6,135)   |
| Redemption of Operating Partnership units held by noncontrolling interest |           | (41)      |
| Net proceeds from exercise of stock options                               | 2,717     | 5,876     |
| Dividends paid on common stock                                            | (155,410) | (116,712) |
| Distributions to noncontrolling interests                                 | (14,256)  | (9,112)   |
| Net cash provided by (used in) financing activities                       | 22,870    | (47,367)  |
| Net (decrease) increase in cash and cash equivalents                      | (77,507)  | 50,914    |
| Cash and cash equivalents, beginning of the period                        | 126,723   | 30,785    |
| Cash and cash equivalents, end of the period                              | \$ 49,216 | \$ 81,699 |

See accompanying notes to unaudited condensed consolidated financial statements.

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

(amounts in thousands)

(unaudited)

|                                                                             | <b>For the Nine Months Ended September 30,</b> |             |
|-----------------------------------------------------------------------------|------------------------------------------------|-------------|
|                                                                             | <b>2014</b>                                    | <b>2013</b> |
| <b>Supplemental schedule of cash flow information</b>                       |                                                |             |
| Interest paid                                                               | \$ 55,694                                      | \$ 46,360   |
| Income taxes paid                                                           | 3,237                                          | 1,626       |
| <b>Supplemental schedule of noncash investing and financing activities:</b> |                                                |             |
| Tax effect from vesting of restricted stock grants and option exercises     |                                                |             |
| Other assets                                                                | \$ 2,883                                       | \$ 3,147    |
| Paid-in capital                                                             | (2,883)                                        | (3,147)     |
| Acquisitions of real estate assets                                          |                                                |             |
| Real estate assets, net                                                     | \$ 60,465                                      | \$ 210,372  |
| Notes payable assumed                                                       | (38,347)                                       | (7,122)     |
| Notes payable assumed and immediately defeased                              |                                                | (98,960)    |
| Value of Operating Partnership units issued                                 | (22,118)                                       | (102,039)   |
| Receivables from related parties and affiliated real estate joint ventures  |                                                | (2,251)     |

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, unless otherwise stated**

**1. ORGANIZATION**

Extra Space Storage Inc. (the "Company") is a fully-integrated, self-administered and self-managed real estate investment trust ("REIT"), formed as a Maryland corporation on April 30, 2004, to own, operate, manage, acquire, develop and redevelop professionally managed self-storage 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 wholly-owned facilities or by acquiring an equity interest in real estate entities. At September 30, 2014, the Company had direct and indirect equity interests in 810 operating storage facilities. In addition, the Company managed 271 properties for third parties, bringing the total number of operating properties which it owns and/or manages to 1,081. These properties are located in 35 states, Washington, D.C. and Puerto Rico.

The Company operates in three distinct segments: (1) rental operations; (2) tenant reinsurance; and (3) property management, acquisition and development. The rental operations activities include rental operations of self-storage facilities in which we have an ownership interest. 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. The Company's property management, acquisition and development activities include managing, acquiring, developing and selling 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 nine months ended September 30, 2014, are not necessarily indicative of results that may be expected for the year ending December 31, 2014. The condensed consolidated balance sheet as of December 31, 2013 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, 2013, as filed with the Securities and Exchange Commission.



*Reclassifications*

Certain amounts in the Company's 2013 consolidated financial statements and supporting note disclosures have been reclassified to conform to the current period presentation. Such reclassifications did not impact previously reported net income or accumulated deficit.

*Recently Issued Accounting Standards*

In May 2014, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers* (ASU 2014-09). ASU 2014-09 amends the guidance for revenue recognition to replace numerous, industry-specific requirements and converges areas under this topic with those of the International Financial Reporting Standards. ASU 2014-09 outlines a five-step process for customer contract revenue recognition that focuses on transfer of control, as opposed to transfer of risk and rewards. The amendment also requires enhanced disclosures regarding the nature, amount, timing and uncertainty of revenues and cash flows from contracts with customers. ASU 2014-09 is effective for reporting periods beginning after December 15, 2016, and early adoption is prohibited. Entities can transition to the standard either retrospectively or as a cumulative-effect adjustment as of the date of adoption. Management is currently assessing the impact of the adoption of ASU 2014-09 on the Company's condensed consolidated financial statements.

**Table of Contents****3. FAIR VALUE DISCLOSURES***Derivative Financial Instruments*

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

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

Although the Company has determined that the majority of the inputs used to value its derivatives fall within Level 2 of the fair value hierarchy, the credit valuation adjustments associated with its derivatives utilize Level 3 inputs, such as estimates of current credit spreads to evaluate the likelihood of default by the Company and its counterparties. However, as of September 30, 2014, the Company had assessed the significance of the impact of the credit valuation adjustments on the overall valuation of its derivative positions and determined that the credit valuation adjustments were not significant to the overall valuation of its derivatives. As a result, the Company determined that its derivative valuations in their entirety were classified in Level 2 of the fair value hierarchy.

The table below presents the Company's assets and liabilities measured at fair value on a recurring basis as of September 30, 2014, aggregated by the level in the fair value hierarchy within which those measurements fall.

| Description                                       | September 30, 2014 | Fair Value Measurements at Reporting Date Using<br>Quoted Prices in Active<br>Markets<br>for<br>Identical |                                                     |                                                 |
|---------------------------------------------------|--------------------|-----------------------------------------------------------------------------------------------------------|-----------------------------------------------------|-------------------------------------------------|
|                                                   |                    | Assets<br>(Level<br>1)                                                                                    | Significant Other<br>Observable Inputs<br>(Level 2) | Significant<br>Unobservable Inputs<br>(Level 3) |
| Other assets Cash Flow Hedge Swap Agreements      | \$ 7,317           | \$                                                                                                        | \$ 7,317                                            | \$                                              |
| Other liabilities Cash Flow Hedge Swap Agreements | \$ (1,818)         | \$                                                                                                        | \$ (1,818)                                          | \$                                              |

There were no transfers of assets and liabilities between Level 1 and Level 2 during the nine months ended September 30, 2014. The Company did not have any significant assets or liabilities that are re-measured on a recurring basis using significant unobservable inputs as of September 30, 2014 or December 31, 2013.

*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, 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.

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

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

*Fair Value of Financial Instruments*

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, 2014 and December 31, 2013 approximate fair value.

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

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

|                                                                   | <b>September 30, 2014</b> |                | <b>December 31, 2013</b> |                |
|-------------------------------------------------------------------|---------------------------|----------------|--------------------------|----------------|
|                                                                   | Fair Value                | Carrying Value | Fair Value               | Carrying Value |
| Note receivable from Preferred Operating Partnership unit holders | \$ 103,667                | \$ 100,000     | \$ 103,491               | \$ 100,000     |
| Fixed rate notes payable and notes payable to trusts              | \$ 1,318,359              | \$ 1,294,510   | \$ 1,365,290             | \$ 1,368,885   |
| Exchangeable senior notes                                         | \$ 259,843                | \$ 250,000     | \$ 251,103               | \$ 250,000     |

**4. EARNINGS PER COMMON SHARE**

Basic earnings per common share is computed using the two-class method by dividing net income attributable to common stockholders by the weighted average number of common shares outstanding during the period. All outstanding unvested restricted stock awards contain rights to non-forfeitable dividends and participate in

undistributed earnings with common stockholders; accordingly, they are considered participating securities that are included in the two-class method. Diluted earnings per common share measures the performance of the Company over the reporting period while giving effect to all potential common shares that were dilutive and outstanding during the period. The denominator includes the weighted average number of basic shares and the number of additional common shares that would have been outstanding if the potential common shares that were dilutive had been issued, and is calculated using either the two-class, treasury stock or as if-converted method, whichever is most dilutive. Potential common shares are securities (such as options, convertible debt, Series A Participating Redeemable Preferred Units ( Series A Units ), Series B Redeemable Preferred Units ( Series B Units ), Series C Convertible Redeemable Preferred Units ( Series C Units ) and common Operating Partnership units ( OP Units )) that do not have a current right to participate in earnings of the Company but could do so in the future by virtue of their option, redemption or conversion right. In computing the dilutive effect of convertible securities, net income is adjusted to add back any changes in earnings in the period associated with the convertible security. The numerator also is adjusted for the effects of any other non-discretionary changes in income or loss that would result from the assumed conversion of those potential common shares. In computing diluted earnings per common share, only potential common shares that are dilutive (those that reduce earnings per common share) are included. For the three months ended September 30, 2014 and 2013, options to purchase approximately 29,547 and 51,036 shares of common stock, respectively, and for the nine months ended September 30, 2014 and 2013, options to purchase approximately 27,045 and 43,273 shares of common stock, respectively, were excluded from the computation of earnings per common share as their effect would have been anti-dilutive.

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The Operating Partnership had \$250,000 of its 2.375% Exchangeable Senior Notes due 2033 (the Notes) issued and outstanding as of September 30, 2014. The Notes could potentially have a dilutive effect on the Company's earnings per common share calculations. The Notes are exchangeable by holders into shares of the Company's common stock under certain circumstances per the terms of the indenture governing the Notes. The exchange price of the Notes was \$55.62 per share as of September 30, 2014, and could change over time as described in the indenture. The Company has irrevocably agreed to pay only cash for the accreted principal amount of the Notes relative to its exchange obligations, but retained the right to satisfy the exchange obligation in excess of the accreted principal amount in cash and/or common stock. Though the Company has retained that right, Accounting Standards Codification (ASC) 260, *Earnings per Share*, requires an assumption that shares would be used to pay the exchange obligation 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 common share computation. For the three and nine months ended September 30, 2014, no shares related to the Notes were included in the computation for diluted earnings per common share as the per share price of the Company's common stock during this period did not exceed the exchange price.

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

For the purposes of computing the diluted impact on earnings per common share of the potential exchange of Series B Units for common shares upon redemption, where the Company has the option to redeem in cash or shares and where the Company has the ability to settle the redemption in shares, the Company divided the total weighted value of the Series B Units outstanding as of September 30, 2014 of \$39,094 by the average closing price of the Company's common stock for the nine months ended September 30, 2014 of \$50.29 per share. The resulting 777,364 shares were excluded from the computation of earnings per common share as their effect would have been anti-dilutive.

For the purposes of computing the diluted impact on earnings per common share of the potential exchange of Series C Units for common shares upon redemption, where the Company has the option to redeem in cash or shares and where the Company has the ability to settle the redemption in shares, the Company divided the total weighted value of the Series C Units outstanding as of September 30, 2014 of \$24,080 by the average closing price of the Company's common stock for the nine months ended September 30, 2014 of \$50.29 per share. The resulting 478,824 shares were excluded from the computation of earnings per common share as their effect would have been anti-dilutive.

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

|                                                              | For the Three Months Ended<br>September 30, |           | For the Nine Months Ended<br>September 30, |           |
|--------------------------------------------------------------|---------------------------------------------|-----------|--------------------------------------------|-----------|
|                                                              | 2014                                        | 2013      | 2014                                       | 2013      |
| Net income attributable to common stockholders               | \$ 54,228                                   | \$ 29,245 | \$ 133,233                                 | \$ 95,136 |
| Earnings and dividends allocated to participating securities | (125)                                       | (143)     | (366)                                      | (390)     |
| Earnings for basic computations                              | 54,103                                      | 29,102    | 132,867                                    | 94,746    |

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|                                                                                                                        |             |             |             |             |
|------------------------------------------------------------------------------------------------------------------------|-------------|-------------|-------------|-------------|
| Earnings and dividends allocated to participating securities                                                           | 125         |             | 366         |             |
| Income allocated to noncontrolling interest Preferred Operating Partnership (Series A Units) and Operating Partnership | 3,875       | 2,757       | 10,318      | 7,875       |
| Fixed component of income allocated to noncontrolling interest Preferred Operating Partnership (Series A Units)        | (1,438)     | (1,438)     | (4,313)     | (4,313)     |
| Net income for diluted computations                                                                                    | \$ 56,665   | \$ 30,421   | \$ 139,238  | \$ 98,308   |
| Weighted average common shares outstanding:                                                                            |             |             |             |             |
| Average number of common shares outstanding basic                                                                      | 115,726,911 | 110,827,793 | 115,606,845 | 110,624,757 |
| Series A Units                                                                                                         | 989,980     |             | 989,980     |             |
| Common OP Units                                                                                                        | 4,334,118   | 4,346,618   | 4,334,118   | 4,346,618   |
| Unvested restricted stock awards included for treasury stock method                                                    | 294,616     |             | 321,346     |             |
| Dilutive stock options                                                                                                 | 271,929     | 302,734     | 299,600     | 351,684     |
| Average number of common shares outstanding diluted                                                                    | 121,617,554 | 115,477,145 | 121,551,889 | 115,323,059 |
| Earnings per common share                                                                                              |             |             |             |             |
| Basic                                                                                                                  | \$ 0.47     | \$ 0.26     | \$ 1.15     | \$ 0.86     |
| Diluted                                                                                                                | \$ 0.47     | \$ 0.26     | \$ 1.15     | \$ 0.85     |

**Table of Contents****5. PROPERTY ACQUISITIONS AND DISPOSITIONS**

The following table summarizes the Company's acquisitions of operating properties for the nine months ended September 30, 2014, and does not include purchases of raw land or improvements made to existing assets:

| Number of Properties | Date of Acquisition | Consideration Paid |                   |                  |                 |               | Net Liabilities/Equity (Assets) Assumed | Value of OP Units Issued | Number of OP Units Issued | Acquisition Date Fair Value |                   |                 |
|----------------------|---------------------|--------------------|-------------------|------------------|-----------------|---------------|-----------------------------------------|--------------------------|---------------------------|-----------------------------|-------------------|-----------------|
|                      |                     | Total              | Cash Paid         | Loan Assumed     | Non-cash gain   | interest      |                                         |                          |                           | Land                        | Building          | Intangibles     |
| 17                   | 1/7/2014            | \$ 200,588         | \$ 200,525        | \$               | \$              | \$            | \$ 63                                   | \$                       |                           | \$ 53,878                   | \$ 142,840        | \$ 2,973        |
| 1                    | 2/5/2014            | 14,191             | 14,152            |                  |                 |               | 39                                      |                          |                           | 1,767                       | 12,368            | 38              |
| 1                    | 3/4/2014            | 7,000              | 6,974             |                  |                 |               | 26                                      |                          |                           | 2,150                       | 4,734             | 113             |
| 1                    | 3/17/2014           | 15,138             | 15,169            |                  |                 |               | (31)                                    |                          |                           | 1,072                       | 14,028            |                 |
| 1                    | 3/20/2014           | 13,813             | 13,752            |                  |                 |               | 61                                      |                          |                           | 2,381                       | 11,224            | 200             |
| 1                    | 4/3/2014            | 23,649             | 15,158            |                  |                 |               | 157                                     | 8,334                    | 333,360                   | 2,961                       | 19,819            | 242             |
| 1                    | 4/15/2014           | 10,186             | 10,077            |                  |                 |               | 109                                     |                          |                           | 1,640                       | 8,358             | 149             |
| 3                    | 4/25/2014           | 35,275             | 2,726             | 19,111           | 3,438           | 129           | (580)                                   | 10,451                   | 226,285                   | 6,853                       | 27,666            | 579             |
| 1                    | 4/30/2014           | 4,388              | 4,388             |                  |                 |               |                                         |                          |                           | 437                         | 3,808             | 102             |
| 1                    | 5/28/2014           | 17,614             | 294               | 14,079           |                 |               | (92)                                    | 3,333                    | 69,735                    | 4,707                       | 12,604            | 265             |
| 1                    | 6/18/2014           | 7,310              | 7,307             |                  |                 |               | 3                                       |                          |                           | 2,940                       | 4,265             | 93              |
| 1                    | 8/6/2014            | 11,337             | 11,290            |                  |                 |               | 47                                      |                          |                           | 1,132                       | 10,080            | 111             |
| 1                    | 8/8/2014            | 11,246             | 6,134             | 5,157            |                 |               | (45)                                    |                          |                           | 1,047                       | 9,969             | 181             |
| 1                    | 9/3/2014            | 4,259              | 4,225             |                  |                 |               | 34                                      |                          |                           | 529                         | 3,604             | 81              |
| <b>32</b>            |                     | <b>\$ 375,994</b>  | <b>\$ 312,171</b> | <b>\$ 38,347</b> | <b>\$ 3,438</b> | <b>\$ 129</b> | <b>\$ (209)</b>                         | <b>\$ 22,118</b>         | <b>629,380</b>            | <b>\$ 83,494</b>            | <b>\$ 285,367</b> | <b>\$ 5,127</b> |

(1) This property was owned by Spencer F. Kirk, the Company's Chief Executive Officer, and Kenneth M. Woolley, the Company's Executive Chairman. The Company acquired the building on March 4, 2014. In a separate transaction on March 5, 2014, the Company acquired the land for \$2,150 from a third party unrelated to the Company's executives and terminated the existing ground lease.

(2) The Company previously held no equity interest in two of the three properties acquired. The Company acquired its joint venture partner's 60% interest in an existing joint venture which held one property in California, resulting in full ownership by the Company. Prior to the acquisition date, the Company accounted for its 40% interest in this joint venture as an equity method investment. The total acquisition date fair value of the previous equity interest was approximately \$3,567 and is included as consideration transferred. The Company recognized a non-cash gain of \$3,438 as a result of remeasuring its prior equity interest in this joint venture held before the acquisition. The three properties were acquired in exchange for approximately \$2,726 of cash and 226,285 Series C Units valued at \$10,451.

On August 29, 2013, the Operating Partnership completed the purchase of 19 out of 20 self-storage facilities affiliated with All Aboard Mini Storage, all of which are located in California. On September 26, 2013, the Operating Partnership completed the purchase of the remaining facility. These properties were acquired in exchange for \$100,876 in cash (including \$98,960 of debt assumed and immediately defeased at closing), 1,342,727 Series B Units valued at \$33,568 and 1,448,108 common OP Units valued at \$62,341. In accordance with ASC 805, *Business*



*Combinations*, the assumed debt was recorded at its fair value as of the closing date. The difference between the price paid to extinguish the debt, which included \$9,153 of defeasance costs, and the carrying value of the debt was recorded as loss on extinguishment of debt related to portfolio acquisition on the Company's condensed consolidated statement of operations.

On May 16, 2013, the Company sold a property located in New York for \$950. No gain or loss was recorded as a result of the sale.

#### **6. GAIN (LOSS) ON SALE OF REAL ESTATE AND EARNOUT FROM PRIOR ACQUISITIONS**

During 2011, the Company acquired a self-storage property located in Florida. As part of this acquisition, the Company agreed to make an additional cash payment to the sellers if the net rental income generated by the acquired property exceeded a specified amount for any twelve-month period prior to June 30, 2015. At the time of acquisition, the Company believed that it was unlikely that any significant payment would be made as a result of this earnout provision. Based on the recent and projected net rental income of this property, the Company estimated that an earnout payment of \$2,500 will be due to the seller. This amount is included in Gain (loss) on sale of real estate and earnout from prior acquisitions on the Company's condensed consolidated statements of operations.

During 2012, the Company acquired a portfolio of ten self-storage properties located in New York and New Jersey. As part of this acquisition, the Company agreed to make an additional cash payment to the sellers if the properties acquired exceeded a specified amount of net rental income after two years. At the time of acquisition, the Company believed that it was unlikely that any significant payment would be made as a result of this earnout provision. The rental growth of the properties has been higher than expected, resulting in a payment to the sellers of \$7,785. This amount is included in Gain (loss) on sale of real estate and earnout from prior acquisitions on the Company's condensed consolidated statements of operations.

In June 2013, the Company recorded a gain of \$800 due to the condemnation of a portion of land at one self-storage property in California that resulted from eminent domain.

**Table of Contents****7. VARIABLE INTERESTS**

The Company has an interest in one unconsolidated joint venture with an unrelated third party which is a variable interest entity ( VIE ). The Company holds an 18% equity interest and a 50% profit interest in the VIE joint venture ( VIE JV ), and has 50% of the voting rights in the VIE JV. Qualification as a VIE was based on the determination that the equity investment at risk for this joint venture was not sufficient based on a qualitative and quantitative analysis performed by the Company. The Company performed a qualitative analysis for the joint venture to determine which party was the primary beneficiary. The Company determined that since the powers to direct the activities most significant to the economic performance of the entity are shared equally by the Company and its joint venture partner, there is no primary beneficiary. Accordingly, the interest is recorded using the equity method.

The VIE JV owns a single self-storage property. This joint venture is financed through a combination of (1) equity contributions from the Company and its joint venture partner and (2) amounts payable to the Company. The amounts payable to the Company consist of expenses paid on behalf of the joint venture by the Company as manager and mortgage notes payable to the Company. The Company performs management services for the VIE JV in exchange for a management fee of approximately 6% of cash collected by the property. The Company completed the purchase of the VIE JV's mortgage loan on April 3, 2014. The mortgage notes payable are in default as of September 30, 2014. Except as disclosed, the Company has not provided financial or other support during the periods presented to the VIE JV that it was not previously contractually obligated to provide.

The Company's maximum exposure to loss for this joint venture as of September 30, 2014 is the total of the amounts payable to the Company and the Company's investment balance in the joint venture. The Company believes that the risk of incurring a material loss as a result of its investment in the property is unlikely and, therefore, no liability has been recorded. Also, repossessing and/or selling the self-storage facility and land that collateralize the amounts payable to the Company could provide funds sufficient to reimburse the Company.

The following table compares the liability balance and the maximum exposure to loss related to the Company's VIE JV as of September 30, 2014:

|                                   | <b>Amounts</b>               |                               |                                   |                                     |                   |
|-----------------------------------|------------------------------|-------------------------------|-----------------------------------|-------------------------------------|-------------------|
|                                   | <b>Liability<br/>Balance</b> | <b>Investment<br/>Balance</b> | <b>Payable to the<br/>Company</b> | <b>Maximum<br/>Exposure to Loss</b> | <b>Difference</b> |
| Extra Space of Sacramento One LLC | \$                           | \$ (1,232)                    | \$ 10,726                         | \$ 9,494                            | \$ (9,494)        |

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

the condensed consolidated balance sheets.

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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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, 2014:

|           | <b>Notes payable<br/>to Trusts</b> | <b>Investment<br/>Balance</b> | <b>Maximum<br/>exposure to loss</b> | <b>Difference</b> |
|-----------|------------------------------------|-------------------------------|-------------------------------------|-------------------|
| 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, 2014.

**8. DERIVATIVES**

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

**Cash Flow Hedges of Interest Rate Risk**

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

The effective portion of changes in the fair value of derivatives designated and that qualify as cash flow hedges is recorded in accumulated other comprehensive income (OCI) and is subsequently reclassified into earnings in the period that the hedged forecasted transaction affects earnings. A portion of these changes is excluded from accumulated other comprehensive income as it is allocated to noncontrolling interests. During the three and nine months ended September 30, 2014 and 2013, such derivatives were used to hedge the variable cash flows associated with existing variable-rate debt.

The following table summarizes the terms of the Company's 20 derivative financial instruments as of September 30, 2014:

| Hedge Product                                | Current Notional Amounts | Strike        | Effective Dates      | Maturity Dates       |
|----------------------------------------------|--------------------------|---------------|----------------------|----------------------|
| Swap Agreements                              | \$4,687 - \$95,004       | 2.79% - 6.12% | 11/2/2009 - 1/1/2014 | 11/1/2014 - 4/1/2021 |
| <b>Fair Values of Derivative Instruments</b> |                          |               |                      |                      |

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

|                                                       | Asset (Liability) Derivatives |            |                        |            |
|-------------------------------------------------------|-------------------------------|------------|------------------------|------------|
|                                                       | September 30, 2014            |            | December 31, 2013      |            |
|                                                       | Balance Sheet Location        | Fair Value | Balance Sheet Location | Fair Value |
| <b>Derivatives designated as hedging instruments:</b> |                               |            |                        |            |
| Swap Agreements                                       | Other assets                  | \$ 7,317   | Other assets           | \$ 13,630  |
| Swap Agreements                                       | Other liabilities             | \$ (1,818) | Other liabilities      | \$ (3,684) |

**Table of Contents****Effect of Derivative Instruments**

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

| Type            | Classification of<br>Income (Expense) | For the Three Months Ended |                       | For the Nine Months Ended |                       |
|-----------------|---------------------------------------|----------------------------|-----------------------|---------------------------|-----------------------|
|                 |                                       | September 30,<br>2014      | September 30,<br>2013 | September 30,<br>2014     | September 30,<br>2013 |
| Swap Agreements | Interest expense                      | \$ (2,172)                 | \$ (2,307)            | \$ (6,782)                | \$ (6,589)            |

| Type            | Gain (loss)<br>recognized in OCI<br><br>September 30,<br>2014 | Location of amounts<br>reclassified from OCI<br>into income | Gain (loss)<br>reclassified from OCI<br>For the Nine Months Ended<br>September 30,<br>2014 |
|-----------------|---------------------------------------------------------------|-------------------------------------------------------------|--------------------------------------------------------------------------------------------|
|                 |                                                               |                                                             |                                                                                            |
| Swap Agreements | \$ (11,099)                                                   | Interest expense                                            | \$ (6,782)                                                                                 |

| Type            | Gain (loss)<br>recognized in<br>OCI<br><br>September 30, 2013 | Location of amounts<br>reclassified from OCI<br>into income | Gain (loss)<br>reclassified<br>from OCI<br>For the Nine<br>Months Ended<br>September 30,<br>2013 |
|-----------------|---------------------------------------------------------------|-------------------------------------------------------------|--------------------------------------------------------------------------------------------------|
|                 |                                                               |                                                             |                                                                                                  |
| Swap Agreements | \$ 10,837                                                     | Interest expense                                            | \$ (6,589)                                                                                       |

**Credit-risk-related Contingent Features**

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

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

As of September 30, 2014, the fair value of derivatives in a net liability position, which includes accrued interest but excludes any adjustment for nonperformance risk related to these agreements, was \$1,818. As of September 30, 2014, the Company had not posted any collateral related to these agreements. If the Company had breached any of these provisions as of September 30, 2014, it could have been required to settle its obligations under the agreements at their termination value of \$2,003.

## **9. EXCHANGEABLE SENIOR NOTES**

On June 21, 2013, the Operating Partnership issued \$250,000 of its 2.375% Exchangeable Senior Notes due 2033 at a 1.5% discount, or \$3,750. Costs incurred to issue the Notes were approximately \$1,672. These costs are being amortized as an adjustment to interest expense over five years, which represents the estimated term based on the first available redemption date, and are included in other assets in the condensed consolidated balance sheets. The Notes are general unsecured senior obligations of the Operating Partnership and are fully guaranteed by the Company. Interest is payable on January 1 and July 1 of each year beginning January 1, 2014, until the maturity date of July 1, 2033. The Notes bear interest at 2.375% per annum and contain an exchange settlement feature, which provides that the Notes may, under certain circumstances, be exchangeable for cash (for the principal amount of the Notes) and, with respect to any excess exchange value, for cash, shares of the Company's common stock, or a combination of cash and shares of the Company's common stock, at the Company's option. The exchange rate of the Notes as of September 30, 2014 was approximately 17.98 shares of the Company's common stock per \$1,000 principal amount of the Notes.

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

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GAAP requires entities with convertible debt instruments that may be settled entirely or partially in cash upon conversion to separately account for the liability and equity components of the instrument in a manner that reflects the issuer's economic interest cost. The Company therefore accounts for the liability and equity components of the Notes separately. The equity component is included in paid-in capital in stockholders' equity in the condensed consolidated balance sheets, 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 as interest expense over the remaining period of the debt through its first redemption date, July 1, 2018. The effective interest rate on the liability component is 4.0%.

Information about the carrying amount of the equity component, the principal amount of the liability component, its unamortized discount and its net carrying amount for the Notes was as follows for the periods indicated:

|                                            | <b>September 30, 2014</b> |          | <b>December 31, 2013</b> |          |
|--------------------------------------------|---------------------------|----------|--------------------------|----------|
| Carrying amount of equity component        | \$                        | 14,496   | \$                       | 14,496   |
| Principal amount of liability component    | \$                        | 250,000  | \$                       | 250,000  |
| Unamortized discount equity component      |                           | (11,127) |                          | (13,131) |
| Unamortized cash discount                  |                           | (2,793)  |                          | (3,356)  |
| Net carrying amount of liability component | \$                        | 236,080  | \$                       | 233,513  |

The amount of interest cost recognized relating to the contractual interest rate and the amortization of the discount on the liability component of the Notes were as follows for the periods indicated:

|                                   | <b>For the Three Months Ended September 30,</b> |             | <b>For the Nine Months Ended September 30,</b> |             |
|-----------------------------------|-------------------------------------------------|-------------|------------------------------------------------|-------------|
|                                   | <b>2014</b>                                     | <b>2013</b> | <b>2014</b>                                    | <b>2013</b> |
| Contractual interest              | \$ 1,484                                        | \$ 1,484    | \$ 4,452                                       | \$ 1,632    |
| Amortization of discount          | 679                                             | 834         | 2,004                                          | 947         |
| Total interest expense recognized | \$ 2,163                                        | \$ 2,318    | \$ 6,456                                       | \$ 2,579    |

## **10. NONCONTROLLING INTEREST REPRESENTED BY PREFERRED OPERATING PARTNERSHIP UNITS**

### *Classification of Noncontrolling Interests*

GAAP requires a company to present ownership interests in subsidiaries held by parties other than the company in the consolidated financial statements within the equity section, but separate from the company's equity. It also requires the amount of consolidated net income attributable to the parent and to the noncontrolling interest to be clearly identified and presented on the face of the consolidated statement of operations and requires changes in ownership interest to be



accounted for similarly as equity transactions. If noncontrolling interests are determined to be redeemable, they are to be carried at their redemption value as of the balance sheet date and reported as temporary equity.

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

*Series A Participating Redeemable Preferred Units*

On June 15, 2007, the Operating Partnership entered into a Contribution Agreement with various limited partnerships affiliated with AAAA Rent-A-Space to acquire ten self-storage facilities in exchange for 989,980 Series A 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 Series A Units \$100,000. The note receivable bears interest at 4.85% and is due September 1, 2020. The loan is secured by the borrower's Series A Units. The holders of the Series A Units can redeem up to 114,500 Series A Units prior to the maturity date of the loan. If any redemption in excess of 114,500 Series A Units

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occurs prior to the maturity date, the holder of the Series A Units is required to repay the loan as of the date of that redemption. The Series A Units are shown on the condensed consolidated balance sheets net of the \$100,000 loan because the borrower under the loan receivable is also the holder of the Series A Units. Subsequent to the end of the quarter, the holder of the Series A Units redeemed 114,500 units for \$4,794 of cash and 280,331 shares of the Company's common stock for a total value of \$19,175.

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

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

*Series B Redeemable Preferred Units*

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

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

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

The outstanding Series B Units have a liquidation value of \$25.00 per unit for a fixed liquidation value of \$41,902. Holders of the Series B Units receive distributions at an annual rate of 6%. These distributions are cumulative. The Series B Units will become redeemable at the option of the holder on the first anniversary of the date of issuance, which redemption obligation may be satisfied at the Company's option in cash or shares of its common stock.

*Series C Convertible Redeemable Preferred Units*

On November 19, 2013, the Company entered into Contribution Agreements with various entities affiliated with Grupe Properties Co. Inc. (Grupe), under which the Company agreed to acquire twelve self-storage facilities, all of which are located in California. The Company completed the purchase of these self-storage facilities between December 2013 and May 2014. The Company previously held 35% interests in five of these properties and a 40% interest in one property through six separate joint ventures with Grupe. These properties were acquired in exchange for a total of approximately \$45,722 of cash, the assumption of \$37,532 in existing debt, and the issuance of 704,016 Series C Units valued at \$30,960.

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

The outstanding Series C Units have a liquidation value of \$42.10 per unit for a fixed liquidation value of \$29,639. From issuance to the fifth anniversary of issuance, each Series C Unit holder will receive quarterly distributions equal to the quarterly distribution per OP Unit plus \$0.18. Beginning on the fifth anniversary of issuance, each Series C Unit holder will receive a fixed quarterly distribution equal to the aggregate quarterly distribution payable in respect of such Series C Unit during the four quarters immediately preceding the fifth anniversary of issuance, divided by four. These distributions are cumulative. The Series C Units will become redeemable at the option of the holder one year from the date of issuance, which redemption obligation may be satisfied at the Company's option in cash or shares of its common stock. The Series C Units will also become convertible into OP Units at the option of the holder one year from the date of issuance, at a rate of 0.9145 OP Units per Series C Unit converted. This conversion option expires upon the fifth anniversary of the date of issuance.

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### **11. 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. ESS Holding Business Trust II, also a wholly-owned subsidiary of the Company, is a limited partner of the Operating Partnership. Between its general partner and limited partner interests, the Company held a 93.8% ownership interest in the Operating Partnership as of September 30, 2014. The remaining ownership interests in the Operating Partnership (including Preferred Operating Partnership units) of 6.2% are held by certain former owners of assets acquired by the Operating Partnership.

The noncontrolling interest in the Operating Partnership represents OP Units that are not owned by the Company. In conjunction with the formation of the Company, and as a result of subsequent acquisitions, certain persons and entities contributing interests in properties to the Operating Partnership received limited partnership interests in the form of OP Units. Limited partners who received OP Units in the formation transactions or in exchange for contributions for interests in properties have the right to require the Operating Partnership to redeem part or all of their OP Units for cash based upon the fair market value of an equivalent number of shares of the Company's common stock (based on the ten-day average trading price) at the time of the redemption. Alternatively, the Company may, in its sole discretion, elect to acquire those OP Units in exchange for shares of its common stock on a one-for-one basis, subject to anti-dilution adjustments provided in the Partnership Agreement. The ten-day average closing stock price at September 30, 2014 was \$51.31 and there were 4,334,118 OP Units outstanding. Assuming that all of the OP Unit holders exercised their right to redeem all of their OP Units on September 30, 2014 and the Company elected to pay the OP Unit holders cash, the Company would have paid \$222,384 in cash consideration to redeem the units.

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

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

### **12. OTHER NONCONTROLLING INTERESTS**

Other noncontrolling interests represent the ownership interests of various third parties in two consolidated joint ventures as of September 30, 2014. One of these consolidated joint ventures owns one property which was under construction at September 30, 2014. The second consolidated joint venture owns 19 operating properties. The ownership interests of the third-party owners range from 1.0% to 3.3%. Other noncontrolling interests are included in the stockholders' equity section of the Company's condensed consolidated balance sheets. 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 statements of operations.

In May 2013, the Company purchased one of its joint venture partner's 27.7% capital interest and 35.0% profit interest in a previously unconsolidated joint venture for \$950. The partner's interest was reported in other noncontrolling interests prior to the purchase. As a result of the acquisition, the property became wholly-owned by the Company. Since the Company retained its controlling financial interest in the subsidiary, this transaction was accounted for as an equity transaction. The carrying amount of the noncontrolling interest was reduced to zero to reflect the purchase, and the difference between the price paid by the Company and the carrying value of the noncontrolling interest was recorded as an adjustment to equity attributable to the parent.

In February 2013, the Company purchased one of its joint venture partner's 1.7% capital interest and 17.0% profit interest in one of its consolidated joint ventures for \$200. As a result, the Company's capital interest percentage in this joint venture increased from 95.0% to 96.7%. Since the Company retained its controlling financial interest in the subsidiary, this transaction was accounted for as an equity transaction. The carrying amount of the noncontrolling interest was reduced to reflect the purchase and the difference between the price paid by the Company and the adjustment to the carrying value of the noncontrolling interest was recorded as an adjustment to equity attributable to the parent.

**Table of Contents****13. EQUITY IN EARNINGS OF UNCONSOLIDATED REAL ESTATE VENTURES GAIN ON PURCHASE OF JOINT VENTURE PARTNERS INTERESTS**

Between December 2013 and May 2014, as part of the Grupe acquisition, the Company acquired its joint venture partners' 60% to 65% equity interests in six self-storage properties located in California. The Company previously held the remaining 35% to 40% interests in these properties through six separate joint ventures with Grupe. Prior to the acquisition, the Company accounted for its interests in these joint ventures as equity-method investments. The Company recognized a non-cash gain of \$3,438 during the nine months ending September 30, 2014 as a result of re-measuring the fair value of its equity interest in one of these joint ventures held before the acquisition. During the three months ending September 30, 2014, the Company recorded a gain of \$378 as a result of the final cash distributions received from the other five joint ventures associated with the acquisitions that were completed during 2013.

On February 13, 2013, the Company acquired its joint venture partner's 48% equity interest in Extra Space of Eastern Avenue LLC (Eastern Avenue), which owned one self-storage property located in Maryland, for approximately \$5,979. Prior to the acquisition, the remaining 52% interest was owned by the Company, which accounted for its investment in Eastern Avenue using the equity method. The Company recorded a non-cash gain of \$2,215 related to this transaction, which represents the increase in fair value of the Company's interest in Eastern Avenue from its formation to the acquisition date.

On February 13, 2013, the Company acquired its joint venture partner's 61% equity interest in Extra Space of Montrose Avenue LLC (Montrose), which owned one self-storage property located in Illinois, for approximately \$6,878. Prior to the acquisition, the remaining 39% interest was owned by the Company, which accounted for its investment in Montrose using the equity method. The Company recorded a non-cash gain of \$341 related to this transaction, which represents the increase in fair value of the Company's interest in the joint venture from its formation to the acquisition date.

**14. SEGMENT INFORMATION**

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

|                                                   | September 30, 2014 | December 31, 2013 |
|---------------------------------------------------|--------------------|-------------------|
| <b>Balance Sheet</b>                              |                    |                   |
| Investment in unconsolidated real estate ventures |                    |                   |
| Rental operations                                 | \$ 86,232          | \$ 88,125         |
| Total assets                                      |                    |                   |
| Rental operations                                 | \$ 3,960,442       | \$ 3,641,746      |
| Tenant reinsurance                                | 32,520             | 34,393            |
| Property management, acquisition and development  | 232,933            | 301,001           |
|                                                   | \$ 4,225,895       | \$ 3,977,140      |



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|                                                                        | <b>For the Three Months Ended September 30,</b> |             | <b>For the Three Months Ended September 30,</b> |             |
|------------------------------------------------------------------------|-------------------------------------------------|-------------|-------------------------------------------------|-------------|
|                                                                        | <b>2014</b>                                     | <b>2013</b> | <b>2014</b>                                     | <b>2013</b> |
| <b>Statement of Operations</b>                                         |                                                 |             |                                                 |             |
| Total revenues                                                         |                                                 |             |                                                 |             |
| Rental operations                                                      | \$ 144,669                                      | \$ 113,881  | \$ 415,448                                      | \$ 324,144  |
| Tenant reinsurance                                                     | 15,385                                          | 12,294      | 43,356                                          | 34,625      |
| Property management, acquisition and development                       | 7,314                                           | 6,936       | 20,984                                          | 19,910      |
|                                                                        | 167,368                                         | 133,111     | 479,788                                         | 378,679     |
| Operating expenses, including depreciation and amortization            |                                                 |             |                                                 |             |
| Rental operations                                                      | 70,520                                          | 56,428      | 209,082                                         | 167,300     |
| Tenant reinsurance                                                     | 2,930                                           | 2,873       | 8,133                                           | 6,985       |
| Property management, acquisition and development                       | 16,425                                          | 17,746      | 54,021                                          | 48,226      |
|                                                                        | 89,875                                          | 77,047      | 271,236                                         | 222,511     |
| Income (loss) from operations                                          |                                                 |             |                                                 |             |
| Rental operations                                                      | 74,149                                          | 57,453      | 206,366                                         | 156,844     |
| Tenant reinsurance                                                     | 12,455                                          | 9,421       | 35,223                                          | 27,640      |
| Property management, acquisition and development                       | (9,111)                                         | (10,810)    | (33,037)                                        | (28,316)    |
|                                                                        | 77,493                                          | 56,064      | 208,552                                         | 156,168     |
| Gain (loss) on sale of real estate and earnout from prior acquisitions |                                                 |             |                                                 |             |
| Rental operations                                                      |                                                 |             |                                                 | 800         |
| Property management, acquisition and development                       | (2,500)                                         |             | (10,285)                                        |             |
|                                                                        | (2,500)                                         |             | (10,285)                                        | 800         |
| Loss on extinguishment of debt related to portfolio acquisition        |                                                 |             |                                                 |             |
| Property management, acquisition and development                       |                                                 | (9,153)     |                                                 | (9,153)     |
| Interest expense                                                       |                                                 |             |                                                 |             |
| Rental operations                                                      | (20,416)                                        | (15,608)    | (60,074)                                        | (50,657)    |
| Property management, acquisition and development                       | (265)                                           | (656)       | (863)                                           | (1,335)     |
|                                                                        | (20,681)                                        | (16,264)    | (60,937)                                        | (51,992)    |



|                                                                                                                    |           |           |            |            |  |  |  |
|--------------------------------------------------------------------------------------------------------------------|-----------|-----------|------------|------------|--|--|--|
| Non-cash interest expense related to the amortization of discount on equity component of exchangeable senior notes |           |           |            |            |  |  |  |
| Property management, acquisition and development                                                                   | (679)     | (834)     | (2,004)    | (947)      |  |  |  |
| Interest income                                                                                                    |           |           |            |            |  |  |  |
| Tenant reinsurance                                                                                                 | 5         | 5         | 13         | 13         |  |  |  |
| Property management, acquisition and development                                                                   | 181       | 197       | 1,154      | 506        |  |  |  |
|                                                                                                                    | 186       | 202       | 1,167      | 519        |  |  |  |
| 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 unconsolidated real estate ventures                                                          |           |           |            |            |  |  |  |
| Rental operations                                                                                                  | 2,777     | 3,405     | 7,800      | 8,942      |  |  |  |
| Equity in earnings of unconsolidated real estate ventures gain on purchase of joint venture partners interests     |           |           |            |            |  |  |  |
| Rental operations                                                                                                  | 378       |           | 3,816      | 2,556      |  |  |  |
| Income tax (expense) benefit                                                                                       |           |           |            |            |  |  |  |
| Rental operations                                                                                                  | (222)     | 334       | (914)      | (134)      |  |  |  |
| Tenant reinsurance                                                                                                 | 2,011     | (3,300)   | (5,660)    | (12,545)   |  |  |  |
| Property management, acquisition and development                                                                   | (783)     | 685       | 1,237      | 5,532      |  |  |  |
|                                                                                                                    | 1,006     | (2,281)   | (5,337)    | (7,147)    |  |  |  |
| Net income (loss)                                                                                                  |           |           |            |            |  |  |  |
| Rental operations                                                                                                  | 56,666    | 45,584    | 156,994    | 118,351    |  |  |  |
| Tenant reinsurance                                                                                                 | 14,471    | 6,126     | 29,576     | 15,108     |  |  |  |
| Property management, acquisition and development                                                                   | (11,944)  | (19,358)  | (40,160)   | (30,075)   |  |  |  |
|                                                                                                                    | \$ 59,193 | \$ 32,352 | \$ 146,410 | \$ 103,384 |  |  |  |
| Depreciation and amortization expense                                                                              |           |           |            |            |  |  |  |
| Rental operations                                                                                                  | \$ 27,226 | \$ 22,052 | \$ 80,012  | \$ 65,025  |  |  |  |
| Property management, acquisition and development                                                                   | 2,023     | 1,376     | 5,883      | 4,213      |  |  |  |
|                                                                                                                    | \$ 29,249 | \$ 23,428 | \$ 85,895  | \$ 69,238  |  |  |  |

## Statement of Cash Flows

Acquisition of real estate assets

Property management, acquisition and development

|    |          |    |          |    |           |    |          |
|----|----------|----|----------|----|-----------|----|----------|
| \$ | (31,315) | \$ | (23,245) | \$ | (328,235) | \$ | (82,949) |
|----|----------|----|----------|----|-----------|----|----------|

Development and redevelopment of real estate assets

Property management, acquisition and development

|    |         |    |         |    |          |    |         |
|----|---------|----|---------|----|----------|----|---------|
| \$ | (5,330) | \$ | (1,609) | \$ | (11,288) | \$ | (3,941) |
|----|---------|----|---------|----|----------|----|---------|

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**15. COMMITMENTS AND CONTINGENCIES**

As of September 30, 2014, the Company is involved in various legal proceedings and is subject to various claims and complaints arising in the ordinary course of business. In the opinion of management, such litigation, claims and complaints are not expected to have a material adverse effect on the Company's financial condition or results of operations.

**16. SUBSEQUENT EVENTS**

On October 22, 2014, the Company purchased a self-storage property located in Georgia for \$11,000.

On October 24, 2014, the Company purchased a self-storage property located in Colorado for \$6,250.

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

**Amounts in thousands, except property and share data**

#### **CAUTIONARY LANGUAGE**

The following discussion and analysis should be read in conjunction with our *Unaudited Condensed Consolidated Financial Statements* and the *Notes to Unaudited Condensed Consolidated Financial Statements* appearing elsewhere in this report and the *Consolidated Financial Statements*, *Notes to Consolidated Financial Statements* and *Management's Discussion and Analysis of Financial Condition and Results of Operations* contained in our Form 10-K for the year ended December 31, 2013. We make statements in this section that are forward-looking statements within the meaning of the federal securities laws. For a complete discussion of forward-looking statements, see the section in this Form 10-Q entitled *Statement on Forward-Looking Information*.

#### **CRITICAL ACCOUNTING POLICIES**

Our discussion and analysis of our financial condition and results of operations are based on our unaudited condensed consolidated financial statements contained elsewhere in this report, which have been prepared in accordance with GAAP. Our notes to the unaudited condensed consolidated financial statements contained elsewhere in this report and the audited financial statements contained in our Form 10-K for the year ended December 31, 2013 describe the significant accounting policies essential to our unaudited condensed consolidated financial statements. Preparation of our financial statements requires estimates, judgments and assumptions. We believe that the estimates, judgments and assumptions that we have used are appropriate and correct based on information available at the time they were made. These estimates, judgments and assumptions can affect our reported assets and liabilities as of the date of the financial statements, as well as the reported revenues and expenses during the period presented. If there are material differences between these estimates, judgments and assumptions and actual facts, our financial statements may be affected.

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

#### **OVERVIEW**

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

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

We operate in competitive markets, often where consumers have multiple self-storage properties from which to choose. Competition has impacted, and will continue to impact, our property results. We experience seasonal

fluctuations in occupancy levels, with occupancy levels generally higher in the summer months due to increased moving activity. Our operating results depend materially on our ability to lease available self-storage units and actively manage rental rates, and on the ability of our tenants to make required rental payments. We believe that we are able to respond quickly and effectively to changes in local, regional and national economic conditions by centrally adjusting rental rates through the combination of our revenue management team and our industry-leading technology systems.

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

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

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*Acquire self-storage properties.* Our acquisitions team continues to pursue the acquisition of multi-property portfolios and single properties that we believe can provide stockholder value. We have established a reputation as a reliable, ethical buyer, which we believe enhances our ability to negotiate and close acquisitions. In addition, we believe our status as an UPREIT enables flexibility when structuring deals. We continue to see available acquisitions on which to bid and are seeing increasing prices. However, we remain a disciplined buyer and look for acquisitions that will strengthen our portfolio and increase stockholder value.

*Expand our management business.* Our management business enables us to generate increased revenues through management fees and to expand our geographic footprint. We believe this expanded footprint enables us to reduce our operating costs through economies of scale. In addition, we see our management business as a future acquisition pipeline. We pursue strategic relationships with owners whose properties would enhance our portfolio in the event an opportunity arises to acquire such properties.

## **PROPERTIES**

As of September 30, 2014, we owned, had ownership interests in, or managed 1,081 properties in 35 states, Washington, D.C. and Puerto Rico. Of these 1,081 properties, we owned 538 properties, we held joint venture interests in 272 properties, and our taxable REIT subsidiary, Extra Space Management, Inc., operated an additional 271 properties that are owned by third parties. These operating properties contain approximately 80 million square feet of rentable space in approximately 720,000 units.

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

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

As of September 30, 2014, approximately 625,000 tenants were leasing storage units at the 1,081 operating properties that we own and/or manage, primarily on a month-to-month basis, providing the flexibility to increase rental rates over time as market conditions permit. Existing tenants generally receive rate increases at least annually, for which no direct correlation has been drawn to our vacancy trends. Although leases are short-term in duration, the typical tenant tends to remain at our properties for an extended period of time. For properties that were stabilized as of September 30, 2014, the average length of stay was approximately 12.9 months for tenants that vacated during the preceding twelve month period.

The average annual rent per square foot for our existing customers at stabilized properties, net of discounts and bad debt, was \$14.62 for the three months ended September 30, 2014, compared to \$13.97 for the same period ended September 30, 2013. Average annual rent per square foot for new leases was \$14.65 for the three months ended September 30, 2014, compared to \$14.34 for the same period ended September 30, 2013. The average discounts, as a percentage of rental revenues, during these periods were 3.3% and 3.9%, respectively.

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

The following table presents additional information regarding the occupancy of our stabilized properties by state as of September 30, 2014 and 2013. The information as of September 30, 2013 is on a pro forma basis as though all the properties owned and/or managed at September 30, 2014 were under our control as of September 30, 2013.

**Table of Contents****Stabilized Property Data Based on Location**

| Location                       | Company              |                        | Pro forma          |                        | Company            |                    | Pro forma          |                    | Company            |                    | Pro forma          |                    |
|--------------------------------|----------------------|------------------------|--------------------|------------------------|--------------------|--------------------|--------------------|--------------------|--------------------|--------------------|--------------------|--------------------|
|                                |                      |                        |                    |                        |                    |                    |                    |                    | Square Foot        |                    | Square Foot        |                    |
|                                | Number of Units as   |                        | Net Rentable       |                        | Net Rentable       |                    | Occupancy          |                    | Occupancy          |                    |                    |                    |
|                                | of Number of Units   |                        | Square Feet as of  |                        | Square Feet as of  |                    | % of               |                    | % of               |                    |                    |                    |
|                                | Number of Properties | September 30, 2014 (1) | September 30, 2013 | September 30, 2014 (2) | September 30, 2013 | September 30, 2014 | September 30, 2013 | September 30, 2014 | September 30, 2013 | September 30, 2014 | September 30, 2013 | September 30, 2013 |
| <b>Wholly-Owned Properties</b> |                      |                        |                    |                        |                    |                    |                    |                    |                    |                    |                    |                    |
| Alabama                        | 5                    | 2,896                  | 2,888              | 342,962                | 343,292            | 83.3%              | 84.1%              |                    |                    |                    |                    |                    |
| Arizona                        | 11                   | 6,942                  | 6,931              | 814,628                | 814,993            | 90.8%              | 88.2%              |                    |                    |                    |                    |                    |
| California                     | 121                  | 90,262                 | 89,450             | 9,334,455              | 9,287,822          | 92.1%              | 88.0%              |                    |                    |                    |                    |                    |
| Colorado                       | 11                   | 5,413                  | 5,353              | 661,334                | 658,730            | 89.6%              | 94.6%              |                    |                    |                    |                    |                    |
| Connecticut                    | 5                    | 3,122                  | 3,132              | 299,579                | 299,924            | 89.7%              | 91.2%              |                    |                    |                    |                    |                    |
| Florida                        | 54                   | 37,405                 | 37,551             | 4,039,024              | 4,058,515          | 92.2%              | 89.3%              |                    |                    |                    |                    |                    |
| Georgia                        | 22                   | 12,964                 | 12,914             | 1,633,322              | 1,629,258          | 89.2%              | 88.4%              |                    |                    |                    |                    |                    |
| Hawaii                         | 5                    | 5,614                  | 5,662              | 335,409                | 334,607            | 91.2%              | 84.0%              |                    |                    |                    |                    |                    |
| Illinois                       | 18                   | 12,308                 | 12,064             | 1,272,416              | 1,255,582          | 91.3%              | 92.6%              |                    |                    |                    |                    |                    |
| Indiana                        | 9                    | 4,734                  | 4,705              | 555,308                | 553,118            | 90.5%              | 87.0%              |                    |                    |                    |                    |                    |
| Kansas                         | 1                    | 507                    | 503                | 50,361                 | 50,360             | 92.5%              | 95.3%              |                    |                    |                    |                    |                    |
| Kentucky                       | 4                    | 2,169                  | 2,155              | 254,241                | 254,015            | 91.9%              | 92.3%              |                    |                    |                    |                    |                    |
| Louisiana                      | 2                    | 1,408                  | 1,413              | 149,990                | 150,015            | 90.9%              | 88.4%              |                    |                    |                    |                    |                    |
| Maryland                       | 23                   | 17,285                 | 17,203             | 1,817,202              | 1,817,922          | 92.1%              | 91.6%              |                    |                    |                    |                    |                    |
| Massachusetts                  | 35                   | 21,385                 | 21,310             | 2,174,215              | 2,173,798          | 92.7%              | 93.5%              |                    |                    |                    |                    |                    |
| Michigan                       | 3                    | 1,808                  | 1,796              | 257,554                | 254,432            | 91.1%              | 93.2%              |                    |                    |                    |                    |                    |
| Missouri                       | 6                    | 3,224                  | 3,206              | 386,361                | 377,256            | 91.1%              | 89.4%              |                    |                    |                    |                    |                    |
| Nevada                         | 5                    | 3,183                  | 3,184              | 548,594                | 546,649            | 87.9%              | 88.0%              |                    |                    |                    |                    |                    |
| New Hampshire                  | 2                    | 1,009                  | 1,001              | 125,748                | 125,773            | 91.3%              | 91.7%              |                    |                    |                    |                    |                    |
| New Jersey                     | 45                   | 35,486                 | 35,368             | 3,434,561              | 3,420,539          | 93.0%              | 92.9%              |                    |                    |                    |                    |                    |
| New Mexico                     | 3                    | 1,572                  | 1,574              | 217,814                | 216,154            | 87.9%              | 87.0%              |                    |                    |                    |                    |                    |
| New York                       | 19                   | 16,807                 | 16,521             | 1,360,340              | 1,350,584          | 90.3%              | 89.9%              |                    |                    |                    |                    |                    |
| North Carolina                 | 2                    | 1,288                  | 904                | 130,786                | 96,316             | 83.8%              | 91.2%              |                    |                    |                    |                    |                    |
| Ohio                           | 19                   | 10,390                 | 10,264             | 1,365,243              | 1,353,630          | 90.0%              | 90.6%              |                    |                    |                    |                    |                    |
| Oregon                         | 3                    | 2,150                  | 2,144              | 250,450                | 250,410            | 94.7%              | 94.4%              |                    |                    |                    |                    |                    |
| Pennsylvania                   | 9                    | 5,744                  | 5,719              | 649,320                | 648,915            | 91.2%              | 91.1%              |                    |                    |                    |                    |                    |
| Rhode Island                   | 2                    | 1,193                  | 1,181              | 131,291                | 131,281            | 91.2%              | 92.8%              |                    |                    |                    |                    |                    |
| South Carolina                 | 5                    | 2,722                  | 2,709              | 329,625                | 330,260            | 91.6%              | 92.0%              |                    |                    |                    |                    |                    |
| Tennessee                      | 10                   | 5,541                  | 5,482              | 754,003                | 754,030            | 93.1%              | 88.6%              |                    |                    |                    |                    |                    |
| Texas                          | 31                   | 20,122                 | 20,063             | 2,351,295              | 2,346,428          | 90.4%              | 89.4%              |                    |                    |                    |                    |                    |
| Utah                           | 8                    | 4,246                  | 4,035              | 523,056                | 503,531            | 90.5%              | 92.5%              |                    |                    |                    |                    |                    |
| Virginia                       | 28                   | 21,562                 | 21,603             | 2,304,925              | 2,303,056          | 86.1%              | 86.0%              |                    |                    |                    |                    |                    |
| Washington                     | 6                    | 3,573                  | 3,538              | 427,483                | 427,573            | 90.0%              | 83.8%              |                    |                    |                    |                    |                    |
|                                | <b>532</b>           | <b>366,034</b>         | <b>363,526</b>     | <b>39,282,895</b>      | <b>39,118,768</b>  | <b>91.1%</b>       | <b>89.6%</b>       |                    |                    |                    |                    |                    |



**Total Wholly-Owned  
Stabilized**

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| Location                              | Company              |                        | Pro forma          |                        | Company            |                        | Pro forma          |                    | Company            |                    | Pro forma          |                    |
|---------------------------------------|----------------------|------------------------|--------------------|------------------------|--------------------|------------------------|--------------------|--------------------|--------------------|--------------------|--------------------|--------------------|
|                                       | Number of Units      |                        | Number of Units    |                        | Net Rentable       |                        | Net Rentable       |                    | Occupancy          |                    | Occupancy          |                    |
|                                       | Number of Properties | September 30, 2014 (1) | September 30, 2013 | September 30, 2014 (2) | September 30, 2013 | September 30, 2014 (2) | September 30, 2013 | September 30, 2014 | September 30, 2013 | September 30, 2014 | September 30, 2013 | September 30, 2013 |
| <b>Joint-Venture Properties</b>       |                      |                        |                    |                        |                    |                        |                    |                    |                    |                    |                    |                    |
| Alabama                               | 2                    | 1,152                  | 1,147              | 145,196                | 145,198            | 89.0%                  | 90.4%              |                    |                    |                    |                    |                    |
| Arizona                               | 7                    | 4,250                  | 4,224              | 492,508                | 492,841            | 89.5%                  | 89.8%              |                    |                    |                    |                    |                    |
| California                            | 71                   | 51,087                 | 50,895             | 5,261,804              | 5,253,943          | 93.0%                  | 92.2%              |                    |                    |                    |                    |                    |
| Colorado                              | 2                    | 1,323                  | 1,321              | 159,803                | 158,813            | 90.7%                  | 93.4%              |                    |                    |                    |                    |                    |
| Connecticut                           | 7                    | 5,298                  | 5,294              | 611,490                | 611,470            | 92.7%                  | 91.3%              |                    |                    |                    |                    |                    |
| Delaware                              | 1                    | 591                    | 590                | 71,705                 | 71,705             | 92.8%                  | 90.9%              |                    |                    |                    |                    |                    |
| Florida                               | 19                   | 15,249                 | 15,153             | 1,533,275              | 1,522,089          | 91.2%                  | 89.4%              |                    |                    |                    |                    |                    |
| Georgia                               | 2                    | 1,067                  | 1,058              | 152,684                | 151,574            | 91.0%                  | 88.8%              |                    |                    |                    |                    |                    |
| Illinois                              | 5                    | 3,467                  | 3,444              | 365,758                | 365,133            | 93.7%                  | 93.1%              |                    |                    |                    |                    |                    |
| Indiana                               | 5                    | 2,205                  | 2,170              | 287,328                | 284,976            | 90.9%                  | 91.7%              |                    |                    |                    |                    |                    |
| Kansas                                | 2                    | 844                    | 842                | 109,375                | 109,325            | 91.5%                  | 85.4%              |                    |                    |                    |                    |                    |
| Kentucky                              | 4                    | 2,267                  | 2,228              | 257,199                | 254,899            | 88.1%                  | 89.5%              |                    |                    |                    |                    |                    |
| Maryland                              | 12                   | 9,772                  | 9,693              | 955,370                | 954,395            | 91.3%                  | 92.2%              |                    |                    |                    |                    |                    |
| Massachusetts                         | 13                   | 6,931                  | 6,899              | 784,185                | 782,667            | 91.0%                  | 92.4%              |                    |                    |                    |                    |                    |
| Michigan                              | 8                    | 4,808                  | 4,777              | 612,833                | 611,803            | 92.9%                  | 92.2%              |                    |                    |                    |                    |                    |
| Missouri                              | 1                    | 534                    | 531                | 61,225                 | 61,225             | 89.9%                  | 91.4%              |                    |                    |                    |                    |                    |
| Nevada                                | 5                    | 3,043                  | 3,047              | 327,383                | 326,933            | 87.3%                  | 88.7%              |                    |                    |                    |                    |                    |
| New Hampshire                         | 3                    | 1,315                  | 1,305              | 138,000                | 136,674            | 58.1%                  | 86.6%              |                    |                    |                    |                    |                    |
| New Jersey                            | 16                   | 12,969                 | 12,945             | 1,357,294              | 1,358,183          | 90.6%                  | 91.8%              |                    |                    |                    |                    |                    |
| New Mexico                            | 7                    | 3,603                  | 3,602              | 398,194                | 398,225            | 89.8%                  | 87.2%              |                    |                    |                    |                    |                    |
| New York                              | 13                   | 14,171                 | 14,132             | 1,106,502              | 1,106,171          | 92.1%                  | 92.8%              |                    |                    |                    |                    |                    |
| Ohio                                  | 8                    | 3,978                  | 3,959              | 531,237                | 531,312            | 88.9%                  | 91.8%              |                    |                    |                    |                    |                    |
| Oregon                                | 1                    | 653                    | 652                | 64,970                 | 64,970             | 94.1%                  | 92.4%              |                    |                    |                    |                    |                    |
| Pennsylvania                          | 10                   | 7,975                  | 7,958              | 805,342                | 801,705            | 92.8%                  | 91.8%              |                    |                    |                    |                    |                    |
| Tennessee                             | 17                   | 9,420                  | 9,346              | 1,240,967              | 1,238,282          | 91.4%                  | 90.3%              |                    |                    |                    |                    |                    |
| Texas                                 | 17                   | 10,592                 | 10,559             | 1,388,200              | 1,387,340          | 92.8%                  | 93.0%              |                    |                    |                    |                    |                    |
| Virginia                              | 13                   | 9,368                  | 9,358              | 994,609                | 994,426            | 90.7%                  | 91.0%              |                    |                    |                    |                    |                    |
| Washington, DC                        | 1                    | 1,530                  | 1,530              | 102,017                | 102,017            | 93.5%                  | 92.9%              |                    |                    |                    |                    |                    |
| <b>Total Joint-Venture Stabilized</b> | <b>272</b>           | <b>189,462</b>         | <b>188,659</b>     | <b>20,316,453</b>      | <b>20,278,294</b>  | <b>91.5%</b>           | <b>91.5%</b>       |                    |                    |                    |                    |                    |
| <b>Managed Properties</b>             |                      |                        |                    |                        |                    |                        |                    |                    |                    |                    |                    |                    |
| Alabama                               | 7                    | 2,341                  | 2,341              | 355,710                | 355,710            | 84.6%                  | 84.6%              |                    |                    |                    |                    |                    |
| Arizona                               | 3                    | 1,210                  | 1,229              | 226,459                | 230,767            | 85.9%                  | 82.7%              |                    |                    |                    |                    |                    |
| California                            | 60                   | 40,501                 | 40,519             | 5,367,328              | 5,358,838          | 86.0%                  | 78.2%              |                    |                    |                    |                    |                    |
| Colorado                              | 14                   | 7,315                  | 7,279              | 952,442                | 946,427            | 93.2%                  | 93.2%              |                    |                    |                    |                    |                    |
| Connecticut                           | 1                    | 464                    | 478                | 61,625                 | 61,600             | 91.0%                  | 86.4%              |                    |                    |                    |                    |                    |

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|                                    |              |                |                |                   |                   |              |              |
|------------------------------------|--------------|----------------|----------------|-------------------|-------------------|--------------|--------------|
| Florida                            | 33           | 19,960         | 19,667         | 2,366,537         | 2,323,628         | 88.8%        | 84.5%        |
| Georgia                            | 10           | 5,265          | 5,266          | 837,366           | 836,053           | 88.1%        | 86.3%        |
| Hawaii                             | 5            | 4,500          | 4,437          | 278,713           | 271,922           | 86.5%        | 81.3%        |
| Illinois                           | 5            | 2,941          | 2,926          | 324,189           | 318,450           | 92.1%        | 92.2%        |
| Indiana                            | 9            | 5,037          | 5,029          | 618,777           | 619,237           | 91.1%        | 85.1%        |
| Kentucky                           | 1            | 550            | 548            | 67,268            | 67,268            | 91.6%        | 87.6%        |
| Louisiana                          | 1            | 999            | 1,006          | 133,485           | 135,035           | 88.1%        | 77.6%        |
| Maryland                           | 10           | 6,098          | 5,821          | 614,467           | 594,637           | 91.1%        | 92.2%        |
| Mississippi                        | 2            | 1,889          | 1,890          | 281,508           | 281,553           | 87.1%        | 81.0%        |
| Missouri                           | 2            | 1,210          | 1,210          | 150,771           | 152,611           | 92.3%        | 90.5%        |
| Nevada                             | 4            | 3,033          | 3,055          | 315,885           | 315,935           | 75.4%        | 75.1%        |
| New Jersey                         | 7            | 4,054          | 4,052          | 429,543           | 428,823           | 92.7%        | 88.0%        |
| New Mexico                         | 2            | 1,121          | 1,120          | 131,112           | 131,472           | 89.7%        | 91.7%        |
| North Carolina                     | 10           | 5,775          | 5,699          | 704,042           | 702,202           | 91.2%        | 85.2%        |
| Ohio                               | 8            | 2,955          | 2,942          | 429,089           | 428,259           | 90.5%        | 82.6%        |
| Pennsylvania                       | 15           | 6,946          | 6,954          | 861,847           | 858,882           | 88.7%        | 86.1%        |
| South Carolina                     | 5            | 3,220          | 3,242          | 440,880           | 440,780           | 88.5%        | 86.6%        |
| Tennessee                          | 3            | 1,532          | 1,506          | 206,420           | 206,530           | 86.8%        | 87.7%        |
| Texas                              | 20           | 10,452         | 10,191         | 1,438,384         | 1,408,063         | 82.9%        | 82.8%        |
| Utah                               | 3            | 1,603          | 1,612          | 257,090           | 257,340           | 90.8%        | 89.4%        |
| Virginia                           | 4            | 2,514          | 2,511          | 258,506           | 258,556           | 89.1%        | 83.7%        |
| Washington, DC                     | 2            | 1,267          | 1,262          | 112,334           | 112,409           | 91.6%        | 94.2%        |
| Puerto Rico                        | 4            | 2,669          | 2,718          | 286,758           | 287,757           | 84.4%        | 80.2%        |
| <b>Total Managed Stabilized</b>    | <b>250</b>   | <b>147,421</b> | <b>146,510</b> | <b>18,508,535</b> | <b>18,390,744</b> | <b>87.8%</b> | <b>83.5%</b> |
| <b>Total Stabilized Properties</b> | <b>1,054</b> | <b>702,917</b> | <b>698,695</b> | <b>78,107,883</b> | <b>77,787,806</b> | <b>90.4%</b> | <b>88.7%</b> |

- (1) Represents unit count as of September 30, 2014, which may differ from unit count as of September 30, 2013 due to unit conversions or expansions.
- (2) Represents net rentable square feet as of September 30, 2014, which may differ from rentable square feet as of September 30, 2013 due to unit conversions or expansions.

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The following table presents additional information regarding the occupancy of our lease-up properties by state as of September 30, 2014 and 2013. The information as of September 30, 2013 is on a pro forma basis as though all the properties owned and/or managed at September 30, 2014 were under our control as of September 30, 2013.

**Lease-up Property Data Based on Location**

|                                |                      | Company                | Pro forma          | Company                | Pro forma          | Company            | Pro forma          |
|--------------------------------|----------------------|------------------------|--------------------|------------------------|--------------------|--------------------|--------------------|
|                                |                      |                        |                    |                        |                    | Square Foot        | Square Foot        |
|                                |                      | Number of Units        | Number of Units    | Net Rentable           | Net Rentable       | Occupancy          | Occupancy          |
|                                |                      | of                     | of                 | Square Feet as of      | Square Feet as of  | %                  | %                  |
| Location                       | Number of Properties | September 30, 2014 (1) | September 30, 2013 | September 30, 2014 (2) | September 30, 2013 | September 30, 2014 | September 30, 2013 |
| Wholly-Owned Properties        |                      |                        |                    |                        |                    |                    |                    |
| Arizona                        | 1                    | 615                    | 631                | 71,115                 | 71,355             | 91.3%              | 74.5%              |
| Connecticut                    | 1                    | 1,121                  |                    | 90,515                 |                    | 40.4%              | 0.0%               |
| Maryland                       | 1                    | 988                    | 988                | 103,171                | 102,777            | 66.8%              | 72.9%              |
| Massachusetts                  | 1                    | 686                    | 686                | 72,545                 | 72,565             | 83.0%              | 80.0%              |
| New York                       | 1                    | 822                    | 822                | 100,480                | 100,480            | 91.0%              | 76.6%              |
| Texas                          | 1                    | 840                    |                    | 93,565                 |                    | 51.5%              | 68.4%              |
| Total Wholly-Owned in Lease-up |                      |                        |                    |                        |                    |                    |                    |
|                                | 6                    | 5,072                  | 3,127              | 531,391                | 347,177            | 69.7%              | 63.1%              |
| Managed Properties             |                      |                        |                    |                        |                    |                    |                    |
| Colorado                       | 1                    | 488                    | 496                | 55,005                 | 54,954             | 89.1%              | 84.7%              |
| Florida                        | 2                    | 1,165                  | 1,152              | 143,656                | 143,656            | 81.8%              | 75.9%              |
| Georgia                        | 2                    | 1,197                  | 1,195              | 128,692                | 126,847            | 88.9%              | 59.5%              |
| Illinois                       | 1                    | 673                    | 137                | 46,417                 | 16,067             | 57.7%              | 2.9%               |
| Maryland                       | 3                    | 2,248                  | 2,255              | 214,835                | 215,085            | 89.1%              | 72.9%              |
| New York                       | 1                    | 348                    |                    | 33,764                 |                    | 15.2%              | 0.0%               |
| North Carolina                 | 1                    | 394                    | 394                | 37,780                 | 37,780             | 73.7%              | 73.7%              |
| South Carolina                 | 3                    | 2,012                  | 336                | 202,480                | 46,180             | 23.1%              | 88.8%              |
| Texas                          | 3                    | 2,197                  | 2,210              | 273,604                | 275,293            | 79.1%              | 68.4%              |
| Utah                           | 2                    | 984                    | 984                | 124,342                | 124,342            | 63.2%              | 63.2%              |
| Virginia                       | 2                    | 1,059                  | 600                | 106,411                | 54,880             | 48.7%              | 46.4%              |
| Total Managed in Lease-up      |                      |                        |                    |                        |                    |                    |                    |
|                                | 21                   | 12,765                 | 9,759              | 1,366,986              | 1,095,084          | 67.7%              | 68.5%              |
| Total Lease-up Properties      |                      |                        |                    |                        |                    |                    |                    |
|                                | 27                   | 17,837                 | 12,886             | 1,898,377              | 1,442,261          | 68.3%              | 67.2%              |

- (1) Represents unit count as of September 30, 2014, which may differ from unit count as of September 30, 2013 due to unit conversions or expansions.
- (2) Represents net rentable square feet as of September 30, 2014, which may differ from rentable square feet as of September 30, 2013 due to unit conversions or expansions.

## RESULTS OF OPERATIONS

### Comparison of the three and nine months ended September 30, 2014 and 2013

#### Overview

Results for the three and nine months ended September 30, 2014 included the operations of 810 properties (557 of which were consolidated and 253 of which were in joint ventures accounted for using the equity method) compared to the results for the three and nine months ended September 30, 2013, which included the operations of 754 properties (476 of which were consolidated and 278 of which were in joint ventures accounted for using the equity method).

#### Revenues

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

|                       | For the Three Months Ended September 30, |                   |                  |              | For the Nine Months Ended September 30, |                   |                   |              |
|-----------------------|------------------------------------------|-------------------|------------------|--------------|-----------------------------------------|-------------------|-------------------|--------------|
|                       | 2014                                     | 2013              | \$ Change        | % Change     | 2014                                    | 2013              | \$ Change         | % Change     |
| <b>Revenues:</b>      |                                          |                   |                  |              |                                         |                   |                   |              |
| Property rental       | \$ 144,669                               | \$ 113,881        | \$ 30,788        | 27.0%        | \$ 415,448                              | \$ 324,144        | \$ 91,304         | 28.2%        |
| Tenant reinsurance    | 15,385                                   | 12,294            | 3,091            | 25.1%        | 43,356                                  | 34,625            | 8,731             | 25.2%        |
| Management fees       | 7,314                                    | 6,936             | 378              | 5.4%         | 20,984                                  | 19,910            | 1,074             | 5.4%         |
| <b>Total revenues</b> | <b>\$ 167,368</b>                        | <b>\$ 133,111</b> | <b>\$ 34,257</b> | <b>25.7%</b> | <b>\$ 479,788</b>                       | <b>\$ 378,679</b> | <b>\$ 101,109</b> | <b>26.7%</b> |

**Property Rental** The increases in property rental revenues for the three and nine months ended September 30, 2014 consisted primarily of increases of \$23,389 and \$68,733, respectively, associated with acquisitions completed in 2014 and 2013. We completed

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32 property acquisitions during the nine months ended September 30, 2014 and 78 property acquisitions in 2013. In addition, for the three and nine months ended September 30, 2014, increases of \$7,544 and \$23,068, respectively, resulted from increases in occupancy and rental rates to existing customers at our stabilized and lease up properties, compared to the same period in the prior year. Occupancy at our wholly-owned stabilized properties increased to 91.1% at September 30, 2014, as compared to 89.6% at September 30, 2013. Rental rates to new tenants for the three months ended September 30, 2014 increased an average of 5.4% over the same period in the prior year.

**Tenant Reinsurance** The increase in tenant reinsurance revenues was primarily due to the increase in the number of properties we owned and/or managed. At September 30, 2014, we owned and/or managed 1,081 properties compared to 1,007 at September 30, 2013. In addition, there was an increase of overall customer participation to 70.7% at September 30, 2014 compared to 68.8% at September 30, 2013.

**Management Fees** Our taxable REIT subsidiary, Extra Space Management, Inc., manages properties owned by our joint ventures and third parties. Management fees represent approximately 6% of cash collected from properties owned by third parties and unconsolidated joint ventures. We also earn an asset management fee from one of our joint ventures, equal to 0.5% of the total asset value of the venture, provided certain conditions are met. The increase in management fee revenues was due to an increase in revenues at the managed properties.

**Expenses**

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

|                               | For the Three Months<br>Ended<br>September 30, |           |              |          | For the Nine Months<br>Ended<br>September 30, |            |              |          |
|-------------------------------|------------------------------------------------|-----------|--------------|----------|-----------------------------------------------|------------|--------------|----------|
|                               | 2014                                           | 2013      | \$<br>Change | % Change | 2014                                          | 2013       | \$<br>Change | % Change |
| <b>Expenses:</b>              |                                                |           |              |          |                                               |            |              |          |
| Property operations           | \$ 43,294                                      | \$ 34,376 | \$ 8,918     | 25.9%    | \$ 129,070                                    | \$ 102,275 | \$ 26,795    | 26.2%    |
| Tenant reinsurance            | 2,930                                          | 2,873     | 57           | 2.0%     | 8,133                                         | 6,985      | 1,148        | 16.4%    |
| Acquisition related costs     | 436                                            | 2,427     | (1,991)      | (82.0%)  | 3,885                                         | 3,562      | 323          | 9.1%     |
| General and administrative    | 13,966                                         | 13,943    | 23           | 0.2%     | 44,253                                        | 40,451     | 3,802        | 9.4%     |
| Depreciation and amortization | 29,249                                         | 23,428    | 5,821        | 24.8%    | 85,895                                        | 69,238     | 16,657       | 24.1%    |
| Total expenses                | \$ 89,875                                      | \$ 77,047 | \$ 12,828    | 16.6%    | \$ 271,236                                    | \$ 222,511 | \$ 48,725    | 21.9%    |

**Property Operations** The increases in property operations expense during the three and nine months ended September 30, 2014 consisted primarily of increases in expenses associated with acquisitions completed in 2014 and 2013. We completed 78 property acquisitions during 2013 and 32 property acquisitions during the nine months ended September 30, 2014.

**Tenant Reinsurance** Tenant reinsurance expense represents the costs that are incurred to provide tenant reinsurance. The increase was due to the increase in the number of properties we owned and/or managed. At September 30, 2014,

we owned and/or managed 1,081 properties compared to 1,007 at September 30, 2013. In addition, there was an increase of overall customer participation to 70.7% at September 30, 2014 compared to 68.8% at September 30, 2013.

**Acquisition Related Costs** Acquisition related costs relate to acquisition activities during the periods indicated. We completed the acquisition of 32 properties during the nine months ended September 30, 2014, compared to 28 properties during the same period in the prior year. We completed the acquisition of three properties during the three months ended September 30, 2014, compared to 22 properties during the three months ended September 30, 2013.

**General and Administrative** General and administrative expenses primarily include all expenses not directly related to our properties, including corporate payroll, travel and professional fees. These expenses are recognized as incurred. General and administrative expenses for the three and nine months ended September 30, 2014 increased when compared to the same period in the prior year primarily due to the overall cost associated with the management of additional properties. At September 30, 2014, we owned and/or managed 1,081 properties, compared to 1,007 properties at September 30, 2013. In addition, we incurred a one-time expense of \$938 related to our point of sale system during the three months ended March 31, 2014. We did not observe any material trends in specific payroll, travel or other expenses that contributed significantly to the increase in general and administrative expenses apart from the increase due to the management of additional properties.

**Depreciation and Amortization** Depreciation and amortization expense increased as a result of the acquisition of new properties. We acquired 32 properties during the nine months ended September 30, 2014 and 78 properties during 2013.

**Table of Contents****Other Revenues and Expenses**

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

|                                                                                                                | For the Three<br>Months<br>Ended<br>September 30, |          |            |          | For the Nine<br>Months<br>Ended<br>September 30, |          |             |            |
|----------------------------------------------------------------------------------------------------------------|---------------------------------------------------|----------|------------|----------|--------------------------------------------------|----------|-------------|------------|
|                                                                                                                | 2014                                              | 2013     | \$ Change  | % Change | 2014                                             | 2013     | \$ Change   | % Change   |
| <b>Other income and expenses:</b>                                                                              |                                                   |          |            |          |                                                  |          |             |            |
| Gain (loss) on sale of real estate and earnout from prior acquisitions                                         | \$ (2,500)                                        | \$       | \$ (2,500) | 100.0%   | \$ (10,285)                                      | \$ 800   | \$ (11,085) | (1,285.6%) |
| Loss on extinguishment of debt related to portfolio acquisition                                                |                                                   | (9,153)  | 9,153      | 100.0%   |                                                  | (9,153)  | 9,153       | 100.0%     |
| Interest expense                                                                                               | (20,681)                                          | (16,264) | (4,417)    | 27.2%    | (60,937)                                         | (51,992) | (8,945)     | 17.2%      |
| Non-cash interest expense related to amortization of discount on equity component of exchangeable senior notes | (679)                                             | (834)    | 155        | (18.6%)  | (2,004)                                          | (947)    | (1,057)     | 111.6%     |
| Interest income                                                                                                | 186                                               | 202      | (16)       | (7.9%)   | 1,167                                            | 519      | 648         | 124.9%     |
| Interest income on note receivable from Preferred Operating Partnership unit holder                            | 1,213                                             | 1,213    |            |          | 3,638                                            | 3,638    |             |            |
| Equity in earnings of unconsolidated real estate ventures                                                      | 2,777                                             | 3,405    | (628)      | (18.4%)  | 7,800                                            | 8,942    | (1,142)     | (12.8%)    |
| Equity in earnings of unconsolidated real estate ventures gain on purchase of joint venture partners interests | 378                                               |          | 378        | 100.0%   | 3,816                                            | 2,556    | 1,260       | 49.3%      |
| Income tax (expense) benefit                                                                                   | 1,006                                             | (2,281)  | 3,287      | (144.1%) | (5,337)                                          | (7,147)  | 1,810       | (25.3%)    |



|                          |             |             |          |         |             |             |            |       |
|--------------------------|-------------|-------------|----------|---------|-------------|-------------|------------|-------|
| Total other expense, net | \$ (18,300) | \$ (23,712) | \$ 5,412 | (22.8%) | \$ (62,142) | \$ (52,784) | \$ (9,358) | 17.7% |
|--------------------------|-------------|-------------|----------|---------|-------------|-------------|------------|-------|

**Gain (Loss) on Sale of Real Estate and Earnout from Prior Acquisitions** During 2011, the Company acquired a self-storage property located in Florida. As part of this acquisition, the Company agreed to make an additional cash payment to the sellers if the net rental income generated by the acquired property exceeded a specified amount for any twelve-month period prior to June 30, 2015. At the time of acquisition, the Company believed that it was unlikely that any significant payment would be made as a result of this earnout provision. Based on the recent and projected net rental income of this property, the Company estimated that an earnout payment of \$2,500 will be due to the seller. This amount is included in Gain (loss) on sale of real estate and earnout from prior acquisitions on the Company's condensed consolidated statements of operations.

During 2012, we acquired a portfolio of ten self-storage properties. As part of this acquisition, we agreed to make an additional cash payment to the sellers if the acquired properties exceeded a specified amount of net rental income two years after the acquisition date. At the acquisition date, we believed that it was unlikely that any significant payment would be made as a result of this earnout provision. The rental growth of the properties was significantly higher than expected, resulting in a payment to the sellers of \$7,785, which was recorded as a loss during the nine months ended September 30, 2014.

The \$800 gain on sale of real estate assets recorded for the nine months ended September 30, 2013 was due to the condemnation of a portion of land at one self-storage property we own in California that resulted from eminent domain.

**Loss on Extinguishment of Debt Related to Portfolio Acquisition** The loss on extinguishment of debt occurred as part of the assumption and immediate defeasance of a loan upon the closing of a portfolio acquisition in August 2013.

**Interest Expense** The increase in interest expense during the three and nine months ended September 30, 2014 was the result of an increase in debt over the same periods in the prior year. The total face value of our debt, including our lines of credit, was \$2,188,791 at September 30, 2014 compared to \$1,772,022 at September 30, 2013.

**Non-cash Interest Expense Related to Amortization of Discount on Equity Component of Exchangeable Senior Notes** In June 2013, our Operating Partnership issued \$250,000 of its 2.375% Exchangeable Senior Notes due 2033. This non-cash interest expense represents the amortization of the discount related to the equity component of the exchangeable senior notes issued by our Operating Partnership, which reflects the effective interest rate of 4.0% relative to the carrying amount of the liability.

**Interest Income** Interest income represents amounts earned on cash and cash equivalents deposited with financial institutions and interest earned on notes receivable. The increase for the nine months ended September 30, 2014 relates primarily to an increase in the average balance of notes receivable when compared to the same period in the prior year.

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

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**Equity in Earnings of Unconsolidated Real Estate Ventures** Equity in earnings of unconsolidated real estate ventures represents the income earned through our ownership interests in unconsolidated joint ventures. The decrease is primarily the result of the acquisition of our joint venture partners interests in certain joint ventures during 2013, causing the properties to be wholly-owned by us. There were 253 operating properties owned by unconsolidated joint ventures as of September 30, 2014, compared with 278 properties as of September 30, 2013.

**Equity in Earnings of Unconsolidated Real Estate Ventures Gain on Purchase of Joint Venture Partners Interests** Between December 2013 and May 2014, as part of the Grupe acquisition, the Company acquired its joint venture partners' 60% to 65% equity interests in six self-storage properties located in California. The Company previously held the remaining 35% to 40% interests in these properties through six separate joint ventures with Grupe. Prior to the acquisition, the Company accounted for its interests in these joint ventures as equity-method investments. The Company recognized a non-cash gain of \$3,438 during the nine months ending September 30, 2014 as a result of re-measuring the fair value of its equity interest in one of these joint ventures held before the acquisition. During the three months ending September 30, 2014, the Company recorded a gain of \$378 as a result of the final cash distributions received from the other five joint ventures associated with the acquisitions that were completed during 2013.

In February 2013, we acquired our partner's equity interests in two joint ventures that each held one self-storage property. As a result of the acquisitions, we recognized non-cash gains of \$2,556, which represents the increase in fair values of our prior interests in the joint ventures from their formations to the acquisition dates.

**Income Tax (Expense) Benefit** For the three and nine months ended September 30, 2014, the decrease in income tax expense is related to a royalty fee charged by the REIT to our captive insurance company.

**Net Income Allocated to Noncontrolling Interests**

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

|                                                                                  | For the Three Months<br>Ended September 30, |            |            |          | For the Nine<br>Months<br>Ended<br>September 30, |            |            |          |
|----------------------------------------------------------------------------------|---------------------------------------------|------------|------------|----------|--------------------------------------------------|------------|------------|----------|
|                                                                                  | 2014                                        | 2013       | \$ Change  | % Change | 2014                                             | 2013       | \$ Change  | % Change |
| <b>Net income allocated to noncontrolling interests:</b>                         |                                             |            |            |          |                                                  |            |            |          |
| Net income allocated to Preferred Operating Partnership noncontrolling interests | \$ (2,977)                                  | \$ (2,033) | \$ (944)   | 46.4%    | \$ (8,281)                                       | \$ (5,495) | \$ (2,786) | 50.7%    |
| Net income allocated to Operating Partnership and other noncontrolling interests | (1,988)                                     | (1,074)    | (914)      | 85.1%    | (4,896)                                          | (2,753)    | (2,143)    | 77.8%    |
|                                                                                  | \$ (4,965)                                  | \$ (3,107) | \$ (1,858) | 59.8%    | \$ (13,177)                                      | \$ (8,248) | \$ (4,929) | 59.8%    |

Total income allocated to  
noncontrolling interests:

**Net Income Allocated to Preferred Operating Partnership Noncontrolling Interests** Between December 2013 and May 2014, as part of the Grupe acquisition, our Operating Partnership issued 704,016 Series C Units. The Series C Units have a liquidation value of \$42.10 per unit. From issuance until the fifth anniversary of issuance, the Series C Units receive distributions at an annual rate of \$0.18 plus the then-payable quarterly distribution per OP Unit.

In April 2014, as part of a single property acquisition, our Operating Partnership issued 333,360 Series B Units. In August and September 2013, as part of a portfolio acquisition, our Operating Partnership issued an additional 1,342,727 Series B Units. The Series B Units have a liquidation value of \$25.00 per unit and receive distributions at an annual rate of 6%.

For the three and nine months ended September 30, 2014, income allocated to the Preferred Operating Partnership noncontrolling interest equals the distributions paid to the Series B and Series C Unit holders and the fixed distribution paid to the Series A Unit holder, plus approximately 0.8% of the remaining net income after adjustment for these distributions.

**Net Income Allocated to Operating Partnership and Other Noncontrolling Interests** Income allocated to the Operating Partnership as of September 30, 2014 and 2013 represents approximately 3.5% and 3.4%, respectively, of net income after adjusting for the distributions paid and net income allocated to the Preferred Operating Partnership unit holders. In August and September 2013, as part of a portfolio acquisition, our Operating Partnership issued 1,448,108 OP Units valued at \$62,341.

Income allocated to other noncontrolling interests represents the income allocated to partners in consolidated joint ventures.

**Table of Contents****FUNDS FROM OPERATIONS**

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

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

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

|                                                                        | <b>For the Three Months Ended September 30,</b> |             | <b>For the Nine Months Ended September 30,</b> |             |
|------------------------------------------------------------------------|-------------------------------------------------|-------------|------------------------------------------------|-------------|
|                                                                        | <b>2014</b>                                     | <b>2013</b> | <b>2014</b>                                    | <b>2013</b> |
| <b>Net income attributable to common stockholders</b>                  | \$ 54,228                                       | \$ 29,245   | \$ 133,233                                     | \$ 95,136   |
| Adjustments:                                                           |                                                 |             |                                                |             |
| Real estate depreciation                                               | 25,005                                          | 19,539      | 71,967                                         | 57,616      |
| Amortization of intangibles                                            | 2,759                                           | 2,776       | 9,594                                          | 8,198       |
| (Gain) loss on sale of real estate and earnout from prior acquisitions | 2,500                                           |             | 10,285                                         | (800)       |
| Unconsolidated joint venture real estate depreciation and amortization | 1,131                                           | 1,455       | 3,304                                          | 4,440       |
| Unconsolidated joint venture gain on purchase of partners' interests   | (378)                                           |             | (3,816)                                        | (2,556)     |
| Distributions paid on Series A Preferred Operating Partnership units   | (1,438)                                         | (1,438)     | (4,313)                                        | (4,313)     |
| Income allocated to Operating Partnership noncontrolling interests     | 4,962                                           | 3,092       | 13,170                                         | 8,210       |
| Funds from operations                                                  | \$ 88,769                                       | \$ 54,669   | \$ 233,424                                     | \$ 165,931  |

**SAME-STORE STABILIZED PROPERTY RESULTS**

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

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|                                                          | For the Three Months Ended |            |         | For the Nine Months Ended |            |         |
|----------------------------------------------------------|----------------------------|------------|---------|---------------------------|------------|---------|
|                                                          | September 30,              |            | Percent | September 30,             |            | Percent |
|                                                          | 2014                       | 2013       | Change  | 2014                      | 2013       | Change  |
| Same-store rental and tenant reinsurance revenues        | \$ 123,487                 | \$ 115,154 | 7.2%    | \$ 357,704                | \$ 332,236 | 7.7%    |
| Same-store operating and tenant reinsurance expenses     | 34,866                     | 34,057     | 2.4%    | 105,461                   | 101,916    | 3.5%    |
| Same-store net operating income                          | \$ 88,621                  | \$ 81,097  | 9.3%    | \$ 252,243                | \$ 230,320 | 9.5%    |
| Non same-store rental and tenant reinsurance revenues    | \$ 36,567                  | \$ 11,021  | 231.8%  | \$ 101,100                | \$ 26,533  | 281.0%  |
| Non same-store operating and tenant reinsurance expenses | \$ 11,358                  | \$ 3,192   | 255.8%  | \$ 31,742                 | \$ 7,344   | 332.2%  |
| Total rental and tenant reinsurance revenues             | \$ 160,054                 | \$ 126,175 | 26.9%   | \$ 458,804                | \$ 358,769 | 27.9%   |
| Total operating and tenant reinsurance expenses          | \$ 46,224                  | \$ 37,249  | 24.1%   | \$ 137,203                | \$ 109,260 | 25.6%   |
| Same-store square foot occupancy as of quarter end       | 91.7%                      | 90.7%      |         | 91.7%                     | 90.7%      |         |
| Properties included in same-store                        | 443                        | 443        |         | 443                       | 443        |         |

The increases in same-store rental revenues for the three and nine months ended September 30, 2014, as compared to the three and nine months ended September 30, 2013, were due primarily to an increase in occupancy of 1.0%, lower discounts to new customers and higher rental rates for both new and existing customers. Rental rates to new tenants for the three months ended September 30, 2014 increased an average of 5.4% compared to the same period in the prior year. The increase in same-store operating expenses for the three months ended September 30, 2014 was primarily due to higher property tax expenses. The increase in same-store operating expenses for the nine months ended September 30, 2014 when compared to the prior year was due primarily to increased property taxes and higher snow removal and utility expenses due to the severe weather experienced in the Midwest and Eastern United States during the three months ended March 31, 2014.

**CASH FLOWS**

Cash flows provided by operating activities were \$256,564 and \$198,584, respectively, for the nine months ended September 30, 2014 and 2013. The increase compared to the same period of the prior year primarily related to increases in net income of \$43,026 and increases in depreciation and amortization of \$16,657 and the loss related to the earnout from a prior acquisition of \$2,500 incurred in 2014. These increases were offset by a loss on extinguishment of debt of \$9,153 incurred in 2013.

Cash used in investing activities was \$356,941 and \$100,303, respectively, for the nine months ended September 30, 2014 and 2013. The increase is primarily a result of the increased acquisition activity. Cash used in the acquisition of real estate assets increased by \$245,286 when compared to the prior year. We acquired 32 properties during the nine months ended September 30, 2014 compared to 28 properties acquired during the same period of the prior year. We primarily paid cash for the acquisitions completed in 2014, while we used a combination of cash, OP Units, and the assumption of debt for the acquisitions completed in the prior year.

Cash provided by financing activities was \$22,870 for the nine months ended September 30, 2014. This compares to cash used in financing activities of \$47,367 for the nine months ended September 30, 2013. The change related primarily to a decrease in proceeds from the issuance of exchangeable senior notes of \$246,250 and an increase in dividends paid on common stock of \$38,698. These were offset by an increase in the amount of proceeds from notes payable and lines of credit of \$141,102 and a decrease in the principal payments on notes payable and lines of credit of \$220,061.

## **LIQUIDITY AND CAPITAL RESOURCES**

As of September 30, 2014, we had \$49,216 available in cash and cash equivalents. We intend to use this cash to pay for future acquisitions, to repay debt and for general corporate purposes. We are required to distribute at least 90% of our net taxable income, excluding net capital gains, to our stockholders on an annual basis to maintain our qualification as a REIT.

Our cash and cash equivalents are held in accounts managed by third-party financial institutions and consist of invested cash and cash in our operating accounts. During 2013 and the first nine months of 2014, we experienced no loss or lack of access to our cash or cash equivalents; however, there can be no assurance that access to our cash and cash equivalents will not be impacted by adverse conditions in the financial markets.

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

| <b>Line of Credit</b> | <b>As of September 30, 2014</b> |                 | <b>Interest Rate</b> | <b>Origination Date</b> | <b>Maturity</b> | <b>Basis Rate</b> | <b>Notes</b> |
|-----------------------|---------------------------------|-----------------|----------------------|-------------------------|-----------------|-------------------|--------------|
|                       | <b>Amount Drawn</b>             | <b>Capacity</b> |                      |                         |                 |                   |              |
| Credit Line 1         | \$                              | \$ 85,000       | 2.05%                | 6/4/2010                | 6/3/2016        | LIBOR plus 1.90%  | (1)          |
| Credit Line 2         |                                 | 50,000          | 1.90%                | 11/16/2010              | 2/13/2017       | LIBOR plus 1.75%  | (2)          |
| Credit Line 3         | 40,000                          | 80,000          | 1.85%                | 4/29/2011               | 11/18/2016      | LIBOR plus 1.70%  | (2)          |
| Credit Line 4         |                                 | 50,000          | 1.80%                | 9/29/2014               | 9/29/2017       | LIBOR plus 1.65%  | (2)          |
|                       | \$ 40,000                       | \$ 215,000      |                      |                         |                 |                   |              |

(1) One two-year extension available

(2) Two one-year extensions available

As of September 30, 2014, we had \$2,188,791 face value of debt, resulting in a debt to total enterprise value ratio of 25.7%. As of September 30, 2014, the ratio of total fixed-rate debt and other instruments to total debt was 70.6% (including \$765,673 on which we have interest rate swaps that have been included as fixed-rate debt). The weighted average interest rate of the total of fixed- and variable-rate debt at September 30, 2014 was 3.5%. Certain of our real estate assets are pledged as collateral for our debt. We are subject to certain restrictive covenants relating to our outstanding debt. We were in compliance with all financial covenants at September 30, 2014.

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

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

**OFF-BALANCE SHEET ARRANGEMENTS**



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

**Table of Contents****CONTRACTUAL OBLIGATIONS**

The following table presents information on future payments due by period as of September 30, 2014:

|                                                            | Total        | Payments due by Period: |            |            |                  |
|------------------------------------------------------------|--------------|-------------------------|------------|------------|------------------|
|                                                            |              | Less Than<br>1 Year     | 1-3 Years  | 3-5 Years  | After<br>5 Years |
| Operating leases                                           | \$ 68,849    | \$ 7,819                | \$ 9,513   | \$ 5,759   | \$ 45,758        |
| Notes payable, notes payable to trusts and lines of credit |              |                         |            |            |                  |
| Interest                                                   | 354,298      | 73,891                  | 107,675    | 61,223     | 111,509          |
| Principal                                                  | 2,188,791    | 262,718                 | 659,389    | 708,884    | 557,800          |
| Total contractual obligations                              | \$ 2,611,938 | \$ 344,428              | \$ 776,577 | \$ 775,866 | \$ 715,067       |

The operating leases above include minimum future lease payments on leases for 17 of our operating properties as well as leases of our corporate offices. Two ground leases include additional contingent rental payments based on the level of revenue achieved at the property.

As of September 30, 2014, the weighted average interest rate for all fixed-rate loans was 4.1%, and the weighted-average interest rate for all variable-rate loans was 2.0%.

**FINANCING STRATEGY**

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

the interest rate of the proposed financing;

the extent to which the financing impacts flexibility in managing our properties;

prepayment penalties and restrictions on refinancing;

the purchase price of properties acquired with debt financing;

long-term objectives with respect to the financing;

target investment returns;

the ability of particular properties, and our company as a whole, to generate cash flow sufficient to cover expected debt service payments;

overall level of consolidated indebtedness;

timing of debt and lease maturities;

provisions that require recourse and cross-collateralization;

corporate credit ratios including debt service coverage, debt to total capitalization and debt to undepreciated assets; and

the overall ratio of fixed- and variable-rate debt.

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

**Table of Contents****SEASONALITY**

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

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

**Amounts in thousands, except property and share data, unless otherwise stated**

**Market Risk**

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

**Interest Rate Risk**

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

As of September 30, 2014, we had \$2,188,791 in total face value of debt, of which \$644,281 was subject to variable interest rates (excluding debt with interest rate swaps). If LIBOR were to increase or decrease by 100 basis points, the increase or decrease in interest expense on the variable-rate debt (excluding variable-rate debt with interest rate floors) would increase or decrease future earnings and cash flows by \$5,978 annually.

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

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

|                                                                   | <b>September 30, 2014</b> |                | <b>December 31, 2013</b> |                |
|-------------------------------------------------------------------|---------------------------|----------------|--------------------------|----------------|
|                                                                   | Fair Value                | Carrying Value | Fair Value               | Carrying Value |
| Note receivable from Preferred Operating Partnership unit holders | \$ 103,667                | \$ 100,000     | \$ 103,491               | \$ 100,000     |
| Fixed rate notes payable and notes payable to trusts              | \$ 1,318,359              | \$ 1,294,510   | \$ 1,365,290             | \$ 1,368,885   |
| Exchangeable senior notes                                         | \$ 259,843                | \$ 250,000     | \$ 251,103               | \$ 250,000     |

The fair value of our note receivable from Preferred Operating Partnership unit holders was based on the discounted estimated future cash flows of the note (categorized within Level 3 of the fair value hierarchy); the discount rate used approximated the current market rate for loans with similar maturities and credit quality. The fair values of our fixed-rate notes payable and notes payable to trusts were estimated using the discounted estimated future cash

payments to be made on such debt (categorized within Level 3 of the fair value hierarchy); the discount rates used approximated current market rates for loans, or groups of loans, with similar maturities and credit quality. The fair value of our exchangeable senior notes was estimated using an average market price for similar securities obtained from a third party.

#### **ITEM 4. CONTROLS AND PROCEDURES**

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

We maintain disclosure controls and procedures to ensure that information required to be disclosed in the reports we file pursuant to the Securities Exchange Act of 1934, as amended, or the Exchange Act, are recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure based on the definition of disclosure controls and procedures in Rule 13a-15(e) of the

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Exchange Act. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can only provide a reasonable assurance of achieving the desired control objectives, and in reaching a reasonable level of assurance, management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

We have a disclosure committee that is responsible to ensure that all disclosures we make to our security holders or to the investment community are accurate and complete, fairly present our financial condition and results of operations in all material respects, and are made on a timely basis as required by applicable laws, regulations and stock exchange requirements.

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

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

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

## **PART II. OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS**

We are involved in various legal proceedings and we are subject to various claims and complaints in the ordinary course of business. In the opinion of management, such litigation, claims and complaints are not expected to have a material adverse effect on our financial condition or results of operations either individually or in the aggregate.

### **ITEM 1A. RISK FACTORS**

There have been no material changes in our risk factors from those disclosed in our 2013 Annual Report on Form 10-K.

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

None.

### **ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

**ITEM 4. MINE SAFETY DISCLOSURES**

Not Applicable.

**ITEM 5. OTHER INFORMATION**

None.

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**ITEM 6. EXHIBITS**

- 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certifications of the Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101 The following materials from Extra Space Storage Inc.'s Quarterly Report on Form 10-Q for the quarter ended September 30, 2014 are formatted in XBRL (eXtensible Business Reporting Language): (1) the Condensed Consolidated Balance Sheets, (2) the Condensed Consolidated Statements of Operations, (3) the Condensed Consolidated Statements of Comprehensive Income (4) the Condensed Consolidated Statement of Noncontrolling Interests and Equity, (5) the Condensed Consolidated Statements of Cash Flows and (6) notes to these financial statements.



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**SIGNATURES**

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

EXTRA SPACE STORAGE INC.

*Registrant*

Date: November 6, 2014

/s/ Spencer F. Kirk

Spencer F. Kirk

*Chief Executive Officer*

*(Principal Executive Officer)*

Date: November 6, 2014

/s/ P. Scott Stubbs

P. Scott Stubbs

*Executive Vice President and Chief Financial Officer*

*(Principal Financial Officer)*