

Extra Space Storage Inc.  
Form 10-Q  
November 07, 2007

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

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**FORM 10-Q**

(Mark One)

**x**

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

**For the quarterly period ended September 30, 2007**

**or**

**o**

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

**For the transition period from                      to                      .**

**Commission File Number: 001-32269**

**EXTRA SPACE STORAGE INC.**

(Exact name of registrant as specified in its charter)

**Maryland**

(State or other jurisdiction of incorporation or organization)

**20-1076777**

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

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

(Address of principal executive offices)

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

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

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

Large accelerated filer ☒

Accelerated filer ☐

Non-accelerated filer ☐

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, 2007 was 65,299,160.**

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**STATEMENT ON FORWARD-LOOKING INFORMATION**



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

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

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

changes in general economic conditions and in the markets in which we operate;

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

potential liability for uninsured losses and environmental contamination;

difficulties in our ability to evaluate, finance and integrate acquired and developed properties into our existing operations and to lease up those properties, which could adversely affect our profitability;

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

difficulties in raising capital at reasonable rates, which could impede our ability to grow;

delays in the development and construction process, which could adversely affect our profitability; and

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

**PART I. FINANCIAL INFORMATION**





**ITEM 1. FINANCIAL STATEMENTS**



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

|   | September 30, 2007<br>(unaudited) | December 31, 2006 |
|---|-----------------------------------|-------------------|
| <b>Assets:</b>  |                                   |                   |
| Real estate assets:   |                                   |                   |
| Net operating real estate assets  | \$ 1,707,384                      | \$ 1,382,055      |
| Real estate under development   | 49,943                            | 35,336            |
| Net real estate assets  | 1,757,327                         | 1,417,391         |
| Investments in real estate ventures   | 89,876                            | 88,115            |
| Cash and cash equivalents   | 41,830                            | 70,801            |
| Short-term investments  | 49,200                            |                   |
| Restricted cash   | 36,642                            | 44,282            |
| Receivables from related parties and affiliated real estate joint ventures  | 9,447                             | 15,880            |
| Other assets, net   | 35,253                            | 33,356            |
| Total assets  | \$ 2,019,575                      | \$ 1,669,825      |
| <b>Liabilities, Minority Interests and Stockholders' Equity:</b>  |                                   |                   |
| Notes payable   | \$ 902,930                        | \$ 828,584        |
| Notes payable to trusts   | 119,590                           | 119,590           |
| Exchangeable senior notes   | 250,000                           |                   |
| Line of credit  |                                   |                   |
| Accounts payable and accrued expenses   | 33,951                            | 25,704            |
| Other liabilities   | 18,416                            | 17,234            |
| Total liabilities   | 1,324,887                         | 991,112           |
| Commitments and contingencies   |                                   |                   |
| Minority interest represented by Preferred Operating Partnership units, net of \$100,000 note receivable (Note 15)  | 30,427                            |                   |
| Minority interest in Operating Partnership  | 36,807                            | 34,841            |
| Other minority interests  | 164                               | 317               |
| Stockholders' equity:   |                                   |                   |
| Preferred stock, \$0.01 par value, 50,000,000 shares authorized, no shares issued or outstanding  |                                   |                   |
| Common Stock, \$0.01 par value, 300,000,000 and 200,000,000 shares authorized at September 30, 2007 and December 31, 2006, respectively, and 65,276,108 and 64,167,098 shares issued and outstanding at September 30, 2007 and December 31, 2006 respectively | 653                               | 642               |
| Paid-in capital   | 825,130                           | 822,181           |
| Accumulated deficit   | (198,493)                         | (179,268)         |
| Total stockholders' equity  | 627,290                           | 643,555           |
| Total liabilities, minority interests and stockholders' equity  | \$ 2,019,575                      | \$ 1,669,825      |

See accompanying notes to unaudited condensed consolidated financial statements.

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

|  | Three months ended September 30, |                 | Nine months ended September 30, |                 |
|--|----------------------------------|-----------------|---------------------------------|-----------------|
|  | 2007                             | 2006            | 2007                            | 2006            |
| <b>Revenues:</b>   |                                  |                 |                                 |                 |
| Property rental  | \$ 55,209                        | \$ 44,682       | \$ 149,832                      | \$ 125,877      |
| Management and franchise fees  | 5,169                            | 5,357           | 15,520                          | 15,697          |
| Tenant insurance   | 3,027                            | 716             | 7,858                           | 2,608           |
| Development fees   | 97                               | 47              | 334                             | 272             |
| Other income   | 324                              | 386             | 608                             | 635             |
| <b>Total revenues</b>  | <b>63,826</b>                    | <b>51,188</b>   | <b>174,152</b>                  | <b>145,089</b>  |
| <b>Expenses:</b>   |                                  |                 |                                 |                 |
| Property operations  | 19,607                           | 16,613          | 53,855                          | 46,603          |
| Tenant insurance   | 1,397                            | 284             | 3,587                           | 1,506           |
| Unrecovered development and acquisition costs  | 184                              | (87)            | 593                             | 255             |
| General and administrative   | 9,326                            | 8,598           | 27,534                          | 26,590          |
| Depreciation and amortization  | 10,598                           | 9,253           | 28,517                          | 27,586          |
| <b>Total expenses</b>  | <b>41,112</b>                    | <b>34,661</b>   | <b>114,086</b>                  | <b>102,540</b>  |
| Income before interest, Preferred Operating Partnership, minority interests and equity in earnings of real estate ventures | 22,714                           | 16,527          | 60,066                          | 42,549          |
| Interest expense   | (16,079)                         | (13,429)        | (44,912)                        | (38,198)        |
| Interest income  | 1,821                            | 175             | 6,937                           | 805             |
| Interest income on note receivable from Preferred Unit holder  | 1,280                            |                 | 1,280                           |                 |
| Equity in earnings of real estate ventures   | 1,304                            | 1,340           | 3,693                           | 3,566           |
| Fair value adjustment of obligation associated with Preferred Operating Partnership units (Note 15)                        | 1,054                            |                 | 1,054                           |                 |
| Minority interest - Operating Partnership  | (869)                            | (306)           | (1,768)                         | (585)           |
| Minority interests - other   | 113                              |                 | 153                             |                 |
| <b>Net income</b>  | <b>11,338</b>                    | <b>4,307</b>    | <b>26,503</b>                   | <b>8,137</b>    |
| Fixed distribution paid to Preferred Operating Partnership unit holder (Note 15)   | (1,510)                          |                 | (1,510)                         |                 |
| <b>Net income available to common stockholders</b>   | <b>\$ 9,828</b>                  | <b>\$ 4,307</b> | <b>\$ 24,993</b>                | <b>\$ 8,137</b> |
| Net income per common share  |                                  |                 |                                 |                 |
| Basic  | \$ 0.15                          | \$ 0.08         | \$ 0.39                         | \$ 0.16         |
| Diluted  | \$ 0.15                          | \$ 0.08         | \$ 0.38                         | \$ 0.16         |
| Weighted average number of shares  |                                  |                 |                                 |                 |
| Basic  | 64,901,249                       | 52,501,864      | 64,461,353                      | 51,929,336      |
| Diluted  | 70,567,078                       | 57,072,838      | 69,702,837                      | 56,250,164      |
| <b>Cash dividends paid per common share</b>  | <b>\$ 0.23</b>                   | <b>\$ 0.23</b>  | <b>\$ 0.68</b>                  | <b>\$ 0.68</b>  |

See accompanying notes to unaudited condensed consolidated financial statements.



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

|  | Common Stock<br>Shares | Par Value | Paid-in<br>Capital | Accumulated<br>Deficit | Total<br>Stockholders<br>Equity |
|--|------------------------|-----------|--------------------|------------------------|---------------------------------|
| <b>Balances at December 31, 2006</b>                                   | 64,167,098             | 642       | 822,181            | (179,268)              | 643,555                         |
| Issuance of common stock upon the exercise of options                  | 99,290                 | 1         | 1,338              |                        | 1,339                           |
| Restricted stock grants issued   | 119,329                | 1         |                    |                        | 1                               |
| Restricted stock grants cancelled                                      | (2,607)                |           |                    |                        |                                 |
| Conversion of Contingent Conversion Shares to common stock             | 892,998                | 9         |                    |                        | 9                               |
| Compensation expense related to stock-based awards                     |                        |           | 1,611              |                        | 1,611                           |
| Fixed distribution paid to Preferred Operating Partnership unit holder |                        |           |                    | (1,510)                | (1,510)                         |
| Net income   |                        |           |                    | 26,503                 | 26,503                          |
| Dividends paid on common stock at \$0.6825 per share                   |                        |           |                    | (44,218)               | (44,218)                        |
| <b>Balances at September 30, 2007</b>                                  | 65,276,108             | \$ 653    | \$ 825,130         | \$ (198,493)           | \$ 627,290                      |

See accompanying notes to unaudited condensed consolidated financial statements.

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

|   | Nine months ended September 30, |                   |
|---|---------------------------------|-------------------|
|   | 2007                            | 2006              |
| <b>Cash flows from operating activities:</b>  |                                 |                   |
| Net income  | \$ 26,503                       | \$ 8,137          |
| Adjustments to reconcile net income to net cash provided by operating activities:                   |                                 |                   |
| Depreciation and amortization   | 28,517                          | 27,586            |
| Amortization of deferred financing costs  | 2,457                           | 2,111             |
| Fair value adjustment of obligation associated with Preferred Operating Partnership units (Note 15) | (1,054)                         |                   |
| Stock compensation expense  | 1,611                           | 1,377             |
| Income allocated to minority interests  | 1,615                           | 585               |
| Distributions from operations of real estate ventures in excess of earnings                         | 3,454                           | 3,423             |
| Changes in operating assets and liabilities:  |                                 |                   |
| Receivables from related parties  | 4,835                           | 16,619            |
| Other assets  | 5,045                           | 3,607             |
| Accounts payable and accrued expenses   | 8,247                           | (6,485)           |
| Other liabilities   | (2,378)                         | 3,756             |
| Net cash provided by operating activities   | 78,852                          | 60,716            |
| <b>Cash flows from investing activities:</b>  |                                 |                   |
| Acquisition of real estate assets   | (144,347)                       | (127,826)         |
| Development and construction of real estate assets  | (31,495)                        | (26,301)          |
| Proceeds from sale of real estate assets  | 1,999                           | 728               |
| Investments in real estate ventures   | (4,769)                         | (5,104)           |
| Net purchases of short-term investments   | (49,200)                        |                   |
| Change in restricted cash   | 7,640                           | 1,451             |
| Principal payments received on notes receivable   |                                 | 123               |
| Purchase of equipment and fixtures  | (835)                           | (1,217)           |
| Net cash used in investing activities   | (221,007)                       | (158,146)         |
| <b>Cash flows from financing activities:</b>  |                                 |                   |
| Proceeds from exchangeable senior notes   | 250,000                         |                   |
| Proceeds from notes payable, notes payable to trusts and line of credit                             | 50,102                          | 129,126           |
| Principal payments on notes payable and line of credit  | (31,135)                        | (65,213)          |
| Deferred financing costs  | (7,740)                         | (899)             |
| Loan to Preferred OP unit holder  | (100,000)                       |                   |
| Redemption of Operating Partnership units held by minority interest                                 | (775)                           |                   |
| Proceeds from issuance of common shares, net  |                                 | 194,901           |
| Net proceeds from exercise of stock options   | 1,339                           | 565               |
| Dividends paid on common stock  | (44,218)                        | (35,407)          |
| Distributions to Operating Partnership units held by minority interest                              | (4,389)                         | (2,610)           |
| Net cash provided by financing activities   | 113,184                         | 220,463           |
| Net increase (decrease) in cash and cash equivalents  | (28,971)                        | 123,033           |
| Cash and cash equivalents, beginning of the period  | 70,801                          | 28,653            |
| <b>Cash and cash equivalents, end of the period</b>   | <b>\$ 41,830</b>                | <b>\$ 151,686</b> |



|   | Nine months ended September 30, |           |
|---|---------------------------------|-----------|
|   | 2007                            | 2006      |
| <b>Supplemental schedule of cash flow information</b>                                 |                                 |           |
| Interest paid, net of amounts capitalized   | \$ 37,756                       | \$ 35,379 |
| <b>Supplemental schedule of noncash investing and financing activities:</b>           |                                 |           |
| Acquisitions:   |                                 |           |
| Real estate assets acquired   | \$ 190,185                      | \$ 27,091 |
| Notes payable acquired  | (54,350)                        | (10,878)  |
| Notes receivable  |                                 | (10,298)  |
| Preferred Operating Partnership units issued as consideration                         | (131,499)                       |           |
| Investment in real estate ventures  | (502)                           | (2,785)   |
| Minority interest in Operating Partnership  | (3,834)                         | (3,130)   |
| Conversion of Operating Partnership Units held by minority interests for common stock |                                 | 1,811     |

See accompanying notes to unaudited condensed consolidated financial statements.

**Extra Space Storage Inc.**

**Notes to Condensed Consolidated Financial Statements (unaudited)**

**Amounts in thousands, except share data**

**1. ORGANIZATION**

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

The Company invests in self-storage facilities by acquiring or developing wholly-owned facilities or facilities held through joint ventures with third parties. At September 30, 2007, the Company had direct and indirect equity interests in 585 storage facilities located in 33 states and Washington, D.C.

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

**2. BASIS OF PRESENTATION**

The accompanying unaudited condensed consolidated financial statements of the Company have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and nine months ended September 30, 2007 are not necessarily indicative of results that may be expected for the year ending December 31, 2007. The Condensed Consolidated Balance Sheet as of December 31, 2006 has been derived from the Company's audited financial statements as of that date, but does not include all of the information and footnotes required by GAAP for complete financial statements. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2006 as filed with the Securities and Exchange Commission (SEC).

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

**Recently Issued Accounting Standards**

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

The Company elected to early adopt Topic D-109 which specifically relates to the AAAAA Rent-A-Space acquisition that was completed during the quarter ended June 30, 2007. See Note 15.

### 3. NET INCOME PER SHARE

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

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

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

For the purposes of computing the diluted impact on earnings per share of the potential conversion of Preferred OP units into common shares, where the Company has the option to redeem in cash or shares as discussed in Note 15 and where the Company has stated the positive intent and ability to settle at least \$115 million of the instrument in cash (or net settle a portion of the Preferred OP units against the related outstanding note receivable), only the amount of the instrument in excess of \$115 million is considered in the calculation of shares contingently issuable for the purposes of computing diluted earnings per share as allowed by paragraph 29 of FAS 128.

For the three months ended September 30, 2007 and 2006, options to purchase approximately 1,184,978 and 18,511 shares of common stock, and for the nine months ended September 30, 2007 and 2006, options to purchase approximately 256,506 and 66,560 shares of common stock, respectively, were excluded from the computation of earnings per share as their effect would have been anti-dilutive.

The computation of net income per share is as follows:



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|  | Three months ended<br>September 30, |            | Nine months ended<br>September 30, |            |
|--|-------------------------------------|------------|------------------------------------|------------|
|  | 2007                                | 2006       | 2007                               | 2006       |
| Net income available to common stockholders  | \$ 9,828                            | \$ 4,307   | \$ 24,993                          | \$ 8,137   |
| Add:   |                                     |            |                                    |            |
| Income allocated to minority interest - Preferred and Common Operating Partnership | 869                                 | 306        | 1,768                              | 585        |
| Net income for diluted computations  | \$ 10,697                           | \$ 4,613   | \$ 26,761                          | \$ 8,722   |
| Weighted average common shares outstanding:  |                                     |            |                                    |            |
| Average number of common shares outstanding - basic                                | 64,901,249                          | 52,501,864 | 64,461,353                         | 51,929,336 |
| Operating Partnership units  | 4,025,332                           | 3,737,579  | 4,025,332                          | 3,796,384  |
| Preferred Operating Partnership units  | 961,839                             |            | 340,561                            |            |
| Dilutive stock options, restricted stock and CCS/CCU conversions                   | 678,658                             | 833,395    | 875,591                            | 524,444    |
| Average number of common shares outstanding - diluted                              | 70,567,078                          | 57,072,838 | 69,702,837                         | 56,250,164 |
| Net income per common share  |                                     |            |                                    |            |
| Basic  | \$ 0.15                             | \$ 0.08    | \$ 0.39                            | \$ 0.16    |
| Diluted  | \$ 0.15                             | \$ 0.08    | \$ 0.38                            | \$ 0.16    |

## 4. REAL ESTATE ASSETS

The components of real estate assets are summarized as follows:

|   | September 30, 2007 | December 31, 2006 |
|---|--------------------|-------------------|
| Land  | \$ 442,882         | \$ 361,569        |
| Buildings and improvements                      | 1,347,832          | 1,085,269         |
| Intangible assets - tenant relationships        | 31,194             | 25,436            |
| Intangible lease rights                         | 6,150              | 3,400             |
|   | 1,828,058          | 1,475,674         |
| Less: accumulated depreciation and amortization | (120,674)          | (93,619)          |
| Net operating real estate assets                | 1,707,384          | 1,382,055         |
| Real estate under development                   | 49,943             | 35,336            |
| Net real estate assets                          | \$ 1,757,327       | \$ 1,417,391      |

On August 3, 2007, the Company sold an undeveloped parcel of vacant land in Kendall, Florida for its book value of \$1,999. There was no gain or loss recognized on the sale.

## 5. PROPERTY ACQUISITIONS

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



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| Property Location(s)  | Number of Properties | Date of Acquisition | Total Consideration | Cash Paid  | Loan Assumed | Net Liabilities / (Assets) Assumed | Value of OP Units Issued | Number of OP Units Issued | Source of Acquisition    | Notes |
|---|----------------------|---------------------|---------------------|------------|--------------|------------------------------------|--------------------------|---------------------------|--------------------------|-------|
| Alabama (1),<br>Colorado(1), Indiana<br>(1), Missouri (3),New<br>Mexico (1) | 7                    | 8/31/07             | \$ 36,510           | \$ 13,558  | \$ 23,340    | \$ (388)                           | \$                       |                           | Affiliated joint venture |       |
| Maryland  | 1                    | 8/31/07             | 10,471              | 10,418     |              | 53                                 |                          |                           | Affiliated joint venture |       |
| California  | 1                    | 8/1/2007            | 14,686              | 4,915      |              | 5                                  | 9,766                    | 80,905                    | Unrelated third party    | (1)   |
| California  | 1                    | 6/26/2007           | 11,216              | 196        | 2,822        | 1                                  | 8,197                    | 61,398                    | Unrelated third party    | (1)   |
| California (6) &<br>Hawaii (2)  | 8                    | 6/25/2007           | 126,623             | 11,154     |              | 1,933                              | 113,536                  | 847,677                   | Unrelated third party    | (1)   |
| Georgia   | 3                    | 6/14/2007           | 13,693              | 13,594     |              | 99                                 |                          |                           | Unrelated franchisee     |       |
| California  | 1                    | 6/14/2007           | 18,703              | 867        | 14,062       | (60)                               | 3,834                    | 218,693                   | Unrelated third party    | (2)   |
| Maryland  | 1                    | 6/6/2007            | 14,942              | 8,128      | 6,834        | (20)                               |                          |                           | Unrelated third party    |       |
| California  | 1                    | 6/1/2007            | 4,020               | 4,036      |              | (16)                               |                          |                           | Unrelated third party    |       |
| Florida   | 1                    | 5/31/2007           | 8,975               | 8,882      |              | 93                                 |                          |                           | Unrelated third party    |       |
| California  | 1                    | 5/24/2007           | 5,585               | 5,575      |              | 10                                 |                          |                           | Unrelated third party    |       |
| Maryland  | 1                    | 4/17/2007           | 12,670              | 5,428      | 7,292        | (50)                               |                          |                           | Unrelated third party    |       |
| Florida   | 1                    | 3/27/2007           | 6,320               | 6,257      |              | 63                                 |                          |                           | Unrelated franchisee     |       |
| Maryland  | 1                    | 1/11/2007           | 14,334              | 14,348     |              | (14)                               |                          |                           | Unrelated franchisee     |       |
| Tennessee   | 1                    | 1/5/2007            | 3,684               | 3,672      |              | 12                                 |                          |                           | Unrelated franchisee     |       |
| Arizona   | 1                    | 1/2/2007            | 4,361               | 4,527      |              | (166)                              |                          |                           | Affiliated joint venture |       |
| Total   | 31                   |                     | \$ 306,793          | \$ 115,555 | \$ 54,350    | \$ 1,555                           | \$ 135,333               | 1,208,673                 |                          |       |

Notes:

(1) - Preferred Operating Partnership Units

(2) - Common Operating Partnership Units

## 6. INVESTMENTS IN REAL ESTATE VENTURES

Investments in real estate ventures consisted of the following:

|   | Excess Profit Participation % | Equity Ownership % | Investment balance at September 30, 2007 | Investment balance at December 31, 2006 |
|---|-------------------------------|--------------------|--|---|
| Extra Space West One LLC ( ESW )                      | 40%                           | 5%                 | \$ 1,796                                 | \$ 1,918                                |
| Extra Space Northern Properties Six, LLC<br>( ESNPS ) | 35%                           | 10%                | 1,701                                    | 1,757                                   |
| PRISA Self Storage LLC ( PRISA )                      | 17%                           | 2%                 | 12,791                                   | 13,393                                  |
| PRISA II Self Storage LLC ( PRISA II )                | 17%                           | 2%                 | 10,781                                   | 10,821                                  |
| PRISA III Self Storage LLC ( PRISA III )              | 20%                           | 5%                 | 4,436                                    | 4,534                                   |
| VRS Self Storage LLC ( VRS )                          | 20%                           | 5%                 | 4,542                                    | 4,547                                   |
| WCOT Self Storage LLC ( WCOT )                        | 20%                           | 5%                 | 5,236                                    | 5,287                                   |
| Storage Portfolio I, LLC ( SP I )                     | 40%                           | 25%                | 18,708                                   | 19,260                                  |
| Storage Portfolio Bravo II ( SPB II )                 | 45%                           | 20%                | 14,822                                   | 15,264                                  |
| U-Storage de Mexico S.A. and related entities         | 30-40%                        | 30-40%             | 4,958                                    |   |



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|                                 |        |        |        |           |
|---------------------------------|--------|--------|--------|-----------|
| Other minority owned properties | 10-50% | 10-50% | 10,105 | 11,334    |
|                                 |        | \$     | 89,876 | \$ 88,115 |

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

On March 1, 2007, the Company acquired a 39.5% interest in U-Storage de Mexico S.A., an existing Mexican corporation ( U-Storage ), which currently manages, develops, owns and operates self storage facilities in Mexico. Kenneth T. Woolley, a former Senior Vice President of the Company and son of Kenneth M. Woolley, the CEO of the Company, also acquired a 0.5% interest in U-Storage de Mexico S.A.

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

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|  | Three months ended September 30, |          | Nine months ended September 30, |          |
|--|----------------------------------|----------|---------------------------------|----------|
|  | 2007                             | 2006     | 2007                            | 2006     |
| Equity in earnings of ESW                                      | \$ 411                           | \$ 337   | \$ 1,106                        | \$ 1,018 |
| Equity in earnings of ESNPS                                    | 49                               | 39       | 136                             | 113      |
| Equity in earnings of PRISA                                    | 166                              | 138      | 521                             | 394      |
| Equity in earnings of PRISA II                                 | 153                              | 110      | 430                             | 334      |
| Equity in earnings of PRISA III                                | 86                               | 35       | 220                             | 88       |
| Equity in earnings of VRS                                      | 67                               | 43       | 190                             | 119      |
| Equity in earnings of WCOT                                     | 77                               | 40       | 224                             | 114      |
| Equity in earnings of SP I                                     | 333                              | 291      | 785                             | 740      |
| Equity in earnings of SPB II                                   | 189                              | 210      | 560                             | 599      |
| Equity in earnings (losses) of U-Storage and related entities  | (141)                            |          | (221)                           |          |
| Equity in earnings (losses) of other minority owned properties | (86)                             | 97       | (258)                           | 47       |
|  | \$ 1,304                         | \$ 1,340 | \$ 3,693                        | \$ 3,566 |

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

## 7. SHORT-TERM INVESTMENTS

The Company accounts for its investments in debt and equity securities according to the provisions of Statement of Financial Accounting Standards (SFAS) No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, which requires securities classified as available-for-sale to be stated at fair value. Adjustments to fair value of available-for-sale securities are recorded as a component of other comprehensive income. A decline in the market value of investment securities below cost, that is deemed to be other than temporary, results in a reduction in the carrying amount to fair value. The impairment is charged to earnings and a new cost basis for the security is established. At September 30, 2007, the Company had \$49,200 in highly-liquid auction rate securities (ARS), government and corporate bonds and variable rate demand notes classified as available-for-sale securities. Although these ARS have long-term stated contractual maturities, they can be presented for redemption at auction when rates are reset which is typically every 7, 28 or 35 days. The Company had no realized or unrealized gains or losses related to these securities during the three and nine months ended September 30, 2007. All income related to these investments was recorded as interest income. In accordance with the Company's investment policy, the Company only invests in ARS with high credit quality issuers and limits the amount of investment exposure to any one issuer.

## 8. OTHER ASSETS

The components of other assets are summarized as follows:

|                                | September 30, 2007 | December 31, 2006 |
|--------------------------------|--------------------|-------------------|
| Equipment and fixtures         | \$ 11,918          | \$ 11,083         |
| Less: accumulated depreciation | (8,042)            | (6,564)           |
| Deferred financing costs, net  | 15,132             | 10,511            |
| Prepaid expenses and deposits  | 5,240              | 5,139             |

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|                          |           |           |
|--------------------------|-----------|-----------|
| Accounts receivable, net | 7,192     | 9,373     |
| Investments in Trusts    | 3,590     | 3,590     |
| Other                    | 223       | 224       |
|                          | \$ 35,253 | \$ 33,356 |

**9. NOTES PAYABLE**

The components of notes payable are summarized as follows:

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|  | September 30, 2007 | December 31, 2006 |
|--|--------------------|-------------------|
| <b>Fixed Rate</b>  |                    |                   |
| Mortgage and construction loans with banks bearing interest at fixed rates between 4.65% and 8.33%. The loans are collateralized by mortgages on real estate assets and the assignment of rents. Principal and interest payments are made monthly with all outstanding principal and interest due between March 1, 2008 and January 1, 2023.   | \$ 810,009         | \$ 743,511        |
| <b>Variable Rate</b>   |                    |                   |
| Mortgage and construction loans with banks bearing floating interest rates (including loans subject to interest rate swaps) based on LIBOR. Interest rates are between LIBOR plus 0.65% (5.77% and 6.01% at September 30, 2007 and December 31, 2006, respectively) and LIBOR plus 2.00% (7.12% and 7.35% at September 30, 2007 and December 31, 2006, respectively). The loans are collateralized by mortgages on real estate assets and the assignment of rents. Principal and interest payments are made monthly with all outstanding principal and interest due between December 31, 2008 and March 1, 2011. | 92,921             | 85,073            |
|  | \$ 902,930         | \$ 828,584        |

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

In October 2004, the Company entered into a reverse interest rate swap agreement ( Swap Agreement ) to float \$61,770 of 4.30% fixed interest rate secured notes due in September 2009. Under this Swap Agreement, the Company will receive interest at a fixed rate of 4.30% and pay interest at a variable rate equal to LIBOR plus 0.65%. The Swap Agreement matures at the same time the notes are due. This Swap Agreement is a fair value hedge, as defined by SFAS No. 133, and the fair value of the Swap Agreement is recorded as an asset or liability, with an offsetting adjustment to the carrying value of the related note payable. Monthly variable interest payments are recognized as an increase or decrease in interest expense.

The estimated fair value of the Swap Agreement at September 30, 2007 and December 31, 2006 was reflected as an other liability of \$896 and \$1,925, respectively. The Company recorded additional interest expense relating to the Swap Agreement of \$273 and \$258 for the three months ended September 30, 2007 and 2006, respectively. Interest expense was increased by \$798 and \$540 for the nine months ended September 30, 2007 and 2006, respectively.

On August 31, 2007, as part of the acquisition of our partner's joint venture interest in seven properties, the Company assumed an interest rate cap agreement related to the assumption of the loan on these properties. The Company has designated the interest rate cap agreement as a cash flow hedge of the interest payments resulting from an increase in the interest rate above the rates designated in the interest rate cap agreement. The interest rate cap agreement will allow increases in interest payments based on an increase in the LIBOR rate above the capped rates (5.19% from 1/1/07 to 12/31/07 and 5.48% from 1/1/08 to 12/31/08) on \$23,340 of floating rate debt to be offset by the value of the interest rate cap agreement. The Company is in the process of valuing the hedge as part of the purchase accounting and related allocation for the seven properties.

## 10. NOTES PAYABLE TO TRUSTS

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

During May 2005, ESS Statutory Trust II (the Trust II), a newly formed Delaware statutory trust and a wholly-owned, unconsolidated subsidiary of the Operating Partnership, issued an aggregate of \$41.0 million of preferred securities which

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

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

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

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

## **11. EXCHANGEABLE SENIOR NOTES**

On March 27, 2007, our Operating Partnership issued \$250.0 million of its 3.625% Exchangeable Senior Notes due April 1, 2027 (the Notes ). Costs incurred to issue the Notes were approximately \$5.7 million. These costs are being amortized as an adjustment to interest expense over five years, which represents the estimated term of the Notes, and are included in other assets, net in the Condensed Consolidated Balance Sheet as of September 30, 2007. The Notes are general unsecured senior obligations of the Operating Partnership and are fully guaranteed by the Company. Interest is payable on April 1 and October 1 of each year beginning October 1, 2007 until the maturity date of April 1, 2027. The Notes bear interest at 3.625% per annum and contain an exchange settlement feature, which provides that the Notes may, under certain circumstances, be exchangeable for cash (up to the principal amount of the Notes) and, with respect to any excess exchange value, for cash, shares of our common stock or a combination of cash and shares of our common stock at an initial exchange rate of approximately 42.5822 shares per \$1,000 principal amount of Notes at the option of the Operating Partnership.

The Operating Partnership may redeem the Notes at any time to preserve the Company's status as a REIT. In addition, on or after April 5, 2012, the Operating Partnership may redeem the Notes for cash, in whole or in part, at 100% of the principal amount plus accrued and unpaid interest, upon at least 30 days but not more than 60 days prior written notice to holders of the Notes.

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

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

**12. LINE OF CREDIT**

The Company, as guarantor, and its Operating Partnership had entered into a \$100.0 million revolving line of credit in September 2004, which included a \$10.0 million swingline subfacility (the Credit Facility). The Credit Facility had an interest rate of 175 basis points over LIBOR (6.87% and 7.10% at September 30, 2007 and December 31, 2006, respectively), and was collateralized by mortgages on certain real estate assets. No amounts were outstanding on the line of credit at September 30, 2007 or December 31, 2006. The Credit Facility expired on September 30, 2007.

On October 19, 2007, the Company entered into a new \$100.0 million revolving line of credit (the Credit Line). The Company intends to use the proceeds of the Credit Line for general corporate purposes. The Credit Line has an interest rate of between 100 and 250 basis points over LIBOR, depending on certain financial ratios of the Company. The Credit Line is collateralized by mortgages on certain real estate assets. As of the closing date, the Credit Line had approximately \$97 million of capacity based on the assets collateralizing the Credit Line. The Credit Line matures October 31, 2010.

**13. OTHER LIABILITIES**

The components of other liabilities are summarized as follows:

|                                  | September 30, 2007 | December 31, 2006 |
|----------------------------------|--------------------|-------------------|
| Deferred rental income           | \$ 11,622          | \$ 9,224          |
| Security deposits                | 401                | 291               |
| SUSA lease obligation liability  | 2,655              | 2,838             |
| Fair value of interest rate swap | 896                | 1,925             |
| Other miscellaneous liabilities  | 2,842              | 2,956             |
|                                  | \$ 18,416          | \$ 17,234         |

**14. RELATED PARTY AND AFFILIATED REAL ESTATE JOINT VENTURE TRANSACTIONS**

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

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

Three months ended September 30,

Nine months ended September 30,



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| Entity                          | Type                                  | 2007     | 2006     | 2007   | 2006   |
|---------------------------------|---------------------------------------|----------|----------|--------|--------|
| ESW                             | Affiliated real estate joint ventures | \$ 110   | \$ 103   | \$ 328 | \$ 307 |
| ESNPS                           | Affiliated real estate joint ventures | 113      | 110      | 329    | 316    |
| PRISA                           | Affiliated real estate joint ventures | 1,273    | 1,289    | 3,868  | 3,780  |
| PRISA II                        | Affiliated real estate joint ventures | 1,052    | 1,038    | 3,142  | 3,056  |
| PRISA III                       | Affiliated real estate joint ventures | 475      | 476      | 1,417  | 1,384  |
| VRS                             | Affiliated real estate joint ventures | 292      | 285      | 860    | 838    |
| WCOT                            | Affiliated real estate joint ventures | 387      | 373      | 1,155  | 1,096  |
| SP I                            | Affiliated real estate joint ventures | 319      | 309      | 945    | 910    |
| SPB II                          | Affiliated real estate joint ventures | 254      | 260      | 770    | 777    |
| Extra Space Development ("ESD") | Related party                         | 193      | 129      | 548    | 333    |
| Various                         | Franchisees, third parties and other  | 701      | 985      | 2,158  | 2,900  |
|                                 |                                       | \$ 5,169 | \$ 5,357 | 15,520 | 15,697 |

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

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| Type                                  | Three months ended September 30, |       | Nine months ended September 30, |        |
|---------------------------------------|----------------------------------|-------|---------------------------------|--------|
|                                       | 2007                             | 2006  | 2007                            | 2006   |
| Affiliated real estate joint ventures | \$ 97                            | \$ 16 | \$ 334                          | \$ 163 |
| Related party                         |                                  | 31    |                                 | 109    |
|                                       | \$ 97                            | \$ 47 | \$ 334                          | \$ 272 |

Effective January 1, 2004, the Company entered into a license agreement with Centershift, a related party software provider, to secure a perpetual right for continued use of STORE (the site management software used at all sites operated by the Company) in all aspects of the Company's property acquisition, development, redevelopment and operational activities. The Company paid Centershift \$225 and \$185 for the three months ended September 30, 2007 and 2006, respectively, and \$680 and \$549 for the nine months ended September 30, 2007 and 2006, respectively, relating to the purchase of software and to license agreements.

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

|                                   | September 30, 2007 | December 31, 2006 |
|-----------------------------------|--------------------|-------------------|
| <b>Receivables:</b>               |                    |                   |
| Development fees                  | \$ 2,562           | \$ 2,633          |
| Other receivables from properties | 6,885              | 13,247            |
|                                   | \$ 9,447           | \$ 15,880         |

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

## 15. MINORITY INTEREST REPRESENTED BY PREFERRED OPERATING PARTNERSHIP UNITS

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

On June 25 and 26, 2007, nine of the ten properties were contributed to the Operating Partnership in exchange for consideration totaling \$137.8 million. Preferred OP units totaling 909,075, with a value of \$121.7 million, were issued along with the assumption of approximately \$14.2 million of third-party debt, of which \$11.4 million was paid off at close. The final property was contributed on August 1, 2007 in exchange for consideration totaling \$14.7 million. 80,905 Preferred OP Units with a value of \$9.8 million were issued along with \$4.9 million of cash.

On June 25, 2007, the Company loaned the holders of the Preferred OP Units \$100.0 million. The note receivable bears interest at 4.85%, and is due September 1, 2017. The loan is secured by the borrower's Preferred OP Units. The holders of the Preferred OP Units can convert up to 114,500 Preferred OP Units prior to the maturity date of the loan. If any redemption in excess of 114,500 Preferred OP Units occurs prior to the maturity date, the holder of the Preferred OP Unit is required to repay the loan as of the date of that Preferred OP Unit redemption. Preferred OP Units are shown on the balance sheet net of the \$100.0 million loan under the guidance in EITF No. 85-1, *Classifying Notes Receivable for*

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*Capital* because the borrower under the loan receivable is also the holder of the Preferred OP Units.

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

Per the Partnership Agreement, Preferred OP Units in the amount of \$115.0 million bear a fixed priority return of 5% and have a fixed liquidation value of \$115.0 million. The remaining balance will participate in distributions with and have a

liquidation value equal to that of the common Operating Partnership units. The Preferred OP Units will be redeemable at the option of the holder on or after September 1, 2008, which redemption obligation may be satisfied, at the Company's option, in cash or shares of its common stock.

At issuance, in accordance with SFAS 133: *Accounting for Derivative Instruments and Hedging Activities*, SFAS 150: *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*, EITF 00-19: *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock*, EITF Topic D-109: *Determining the Nature of a Host Contract Related to a Hybrid Financial Instrument Issued in the Form of a Share under FASB Statement No. 133*: and Accounting Series Release (ASR) No. 268: *Presentation in Financial Statements of Redeemable Preferred Stocks*, from inception through September 28, 2007 (the date of the amendment discussed below), the Preferred OP Units were classified as a hybrid instrument such that the value of the units associated with the fixed return were classified in mezzanine after total liabilities on the balance sheet and before stockholders' equity. The remaining balance that participates in distributions equal to that of common OP Units had been identified as an embedded derivative and had been classified as a liability on the balance sheet and recorded at fair value on a quarterly basis with any adjustment being recorded to the income statement. For the three and nine months ended September 30, 2007, the fair value adjustment associated with the embedded derivative was \$1,054.

On September 28, 2007, the Operating Partnership entered into an amendment to the Contribution Agreement. Pursuant to the amendment, the maximum number of shares that can be issued upon redemption of the Preferred OP Units was set at 116 million, after which the Company will have no further obligations with respect to the redeemed or any other remaining Preferred OP Units. As a result of this amendment, and in accordance with the above referenced guidance, the Preferred OP Units are no longer considered a hybrid instrument and the previously identified embedded derivative no longer requires bifurcation and is considered permanent equity of the Operating Partnership and is included on the balance sheet as the minority interest represented by Preferred Operating Partnership units.

## **16. MINORITY INTEREST IN OPERATING PARTNERSHIP**

The Company's interest in its properties is held through the Operating Partnership. ESS Holding Business Trust I, a wholly owned subsidiary of the Company, is the sole general partner of the Operating Partnership. The Company, through ESS Holding Business Trust II, a wholly owned subsidiary of the Company, is also a limited partner of the Operating Partnership. Between its general partner and limited partner interests, the Company held a 92.86% majority ownership interest therein as of September 30, 2007. The remaining ownership interests in the Operating Partnership (including Preferred OP Units) of 7.14% are held by certain former owners of assets acquired by the Operating Partnership, which includes a director and certain officers of the Company.

The minority 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 units in the form of either OP Units or Contingent Conversion 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 at the time of the redemption. Alternatively, the Company may, at its option, elect to acquire those OP Units in exchange for shares of its common stock on a one-for-one basis, subject to anti-dilution adjustments provided in the Operating Partnership agreement.

As of September 30, 2007, the Operating Partnership had 4,032,577 and 154,109 OP Units and CCUs outstanding, respectively.

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

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any CCUs remain unconverted through the calculation made in respect of the 12-month period ending December 31, 2008, such outstanding CCUs will be cancelled.

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

As of September 30, 2007, there were 45,937 CCUs converted to OP Units. Based on the performance of the properties as of September 30, 2007, an additional 24,677 CCUs became eligible for conversion. The board of directors approved the conversion of these CCUs on November 1, 2007 as per the Company's charter, and the units were issued on November 5, 2007.

### 17. STOCKHOLDERS' EQUITY

On September 28, 2007, in connection with an amendment to the Contribution Agreement (see Note 15) the Company amended its charter to increase the authorized number of shares of common stock of the Company from 200,000,000 to 300,000,000. The Company's charter now provides that it can issue up to 300,000,000 shares of common stock, \$0.01 par value per share, 4,100,000 Contingent Conversion Shares, \$0.01 par value per share, and 50,000,000 shares of preferred stock, \$0.01 par value per share. As of September 30, 2007, 65,276,108 shares of common stock were issued and outstanding, 2,995,845 CCSs were issued and outstanding and no shares of preferred stock were issued and outstanding. All stockholders of the Company's common stock are entitled to receive dividends and to one vote on all matters submitted to a vote of stockholders.

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

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

As of September 30, 2007, there were 892,998 CCSs converted to common stock. Based on the performance of the properties as of September 30, 2007, an additional 479,730 CCSs became eligible for conversion. The board of directors approved the conversion of these CCSs on November 1, 2007 as per the Company's charter, and the shares were issued on November 5, 2007.

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On October 29, 2007, the Company's Board of Directors approved an increase in the Company's annual dividend to \$1.00 per common share to be paid quarterly at the rate of \$0.25 per common share starting in the fourth quarter of 2007.

### 18. STOCK-BASED COMPENSATION

#### *Options*

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

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Committee at the time of grant, stock options vest ratably over a four-year period beginning on the date of grant.

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

|                               | Nine Months Ended September 30,<br>2007 | 2006 |
|-------------------------------|---|------|
| Expected volatility           | 24%                                     | 24%  |
| Dividend yield                | 5.8%                                    | 6.4% |
| Risk-free interest rate       | 4.2%                                    | 4.6% |
| Average expected term (years) | 5                                       | 5    |

The Black-Scholes model incorporates assumptions to value stock-based awards. The risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant for the estimated life of the option. The Company uses actual historical data to calculate the expected price volatility and average expected term. The forfeiture rate, which is estimated at a weighted average of 20.65% of unvested options outstanding as of September 30, 2007, is adjusted periodically based on the extent to which actual forfeitures differ, or are expected to differ, from the previous estimate.

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

| Options                           | Number of<br>Shares | Weighted<br>Average Exercise<br>Price | Weighted Average<br>Remaining<br>Contractual Life | Aggregate Intrinsic<br>Value as of<br>September 30, 2007 |
|-----------------------------------|---------------------|---------------------------------------|---|--|
| Outstanding at December 31, 2006  | 2,564,563           | \$ 13.92                              |   |  |
| Granted                           | 418,000             | 18.51                                 |   |  |
| Exercised                         | (99,290)            | 13.55                                 |   |  |
| Forfeited                         | (161,609)           | 14.56                                 |   |  |
| Outstanding at September 30, 2007 | 2,721,664           | \$ 14.55                              | 7.54  | \$ 3,757,019   |
| Vested and Expected to Vest       | 2,085,677           | \$ 14.28                              | 7.41  | \$ 3,192,279   |
| Ending Exercisable                | 1,345,343           | \$ 13.59                              | 7.04  | \$ 2,522,751   |

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

The Company recorded compensation expense relating to outstanding options of \$252 and \$187 for the three months ended September 30, 2007 and 2006, respectively, and \$670 and \$637 for the nine months ended September 30, 2007 and 2006, respectively. The Company received cash from the exercise of options of \$306 and \$871 for the three months ended September 30, 2007 and 2006, respectively, and \$1,339 and \$1,029 for the nine months ended September 30, 2007 and 2006, respectively. At September 30, 2007, there was \$1,219 of total unrecognized compensation expense related to non-vested stock options under the Company's 2004 Long-Term Incentive Compensation Plan. That cost is expected to be recognized over a weighted-average period of 2.11 years. The valuation model applied in this calculation utilizes subjective assumptions that could potentially change over time, including the expected forfeiture rate. Therefore, the amount of unrecognized compensation



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expense at September 30, 2007, noted above does not necessarily represent the expense that will ultimately be realized by the Company in the Statement of Operations.

### *Common Stock Granted to Employees*

Common stock is granted to certain employees without monetary consideration under the Company's 2004 Long-Term Incentive Compensation Plan. At the date of grant, the recipient has all rights of a stockholder including the right to vote and

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receive dividends subject to restrictions on transfer and forfeiture provisions. The forfeiture and transfer restrictions on the shares lapse over a two to four year period beginning on the date of grant.

The Company recorded compensation expense relating to outstanding shares of common stock granted to employees of \$485 and \$174 for the three months ended September 30, 2007 and 2006, respectively, and \$941 and \$740 for the nine months ended September 30, 2007 and 2006, respectively.

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

| Restricted Stock Grants          | Shares   | Weighted-<br>Average Grant-<br>Date Fair Value |
|----------------------------------|----------|--|
| Unreleased at December 31, 2006  | 156,300  | \$ 15.94                                       |
| Granted                          | 119,329  | 18.21  |
| Released                         | (57,875) | 15.69  |
| Cancelled                        | (2,607)  | 18.70  |
| Unreleased at September 30, 2007 | 215,147  | \$ 17.26                                       |

### 19. SEGMENT INFORMATION

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

|  | September 30, 2007 | December 31, 2006 |
|--|--------------------|-------------------|
| <b>Balance Sheet</b>                             |                    |                   |
| Investment in real estate ventures               |                    |                   |
| Rental operations                                | \$ 89,876          | \$ 88,115         |
| Total assets                                     |                    |                   |
| Property management, acquisition and development | \$ 324,056         | \$ 223,402        |
| Rental operations                                | 1,695,519          | 1,446,423         |
|  | \$ 2,019,575       | \$ 1,669,825      |

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|   | Three months ended September 30, |             | Nine months ended September 30, |              |
|---|----------------------------------|-------------|---------------------------------|--------------|
|   | 2007                             | 2006        | 2007                            | 2006         |
| <b>Statement of Operations</b>  |                                  |             |                                 |              |
| Total revenues  |                                  |             |                                 |              |
| Property management, acquisition and development  | \$ 8,617                         | \$ 6,506    | \$ 24,320                       | \$ 19,212    |
| Rental operations   | 55,209                           | 44,682      | 149,832                         | 125,877      |
|   | \$ 63,826                        | \$ 51,188   | \$ 174,152                      | \$ 145,089   |
| Operating expenses, including depreciation and amortization   |                                  |             |                                 |              |
| Property management, acquisition and development  | \$ 11,217                        | \$ 9,020    | \$ 32,626                       | \$ 28,959    |
| Rental operations   | 29,895                           | 25,641      | 81,460                          | 73,581       |
|   | \$ 41,112                        | \$ 34,661   | \$ 114,086                      | \$ 102,540   |
| Income (loss) before interest, Preferred Operating Partnership, minority interests and equity in earnings of real estate ventures |                                  |             |                                 |              |
| Property management, acquisition and development  | \$ (2,600)                       | \$ (2,514)  | \$ (8,306)                      | \$ (9,747)   |
| Rental operations   | 25,314                           | 19,041      | 68,372                          | 52,296       |
|   | \$ 22,714                        | \$ 16,527   | \$ 60,066                       | \$ 42,549    |
| Interest expense  |                                  |             |                                 |              |
| Property management, acquisition and development  | \$ (376)                         | \$ (297)    | \$ (940)                        | \$ (683)     |
| Rental operations   | (15,703)                         | (13,132)    | (43,972)                        | (37,515)     |
|   | \$ (16,079)                      | \$ (13,429) | \$ (44,912)                     | \$ (38,198)  |
| Interest income   |                                  |             |                                 |              |
| Property management, acquisition and development  | \$ 1,821                         | \$ 175      | \$ 6,937                        | \$ 805       |
| Interest income on note receivable from Preferred Unit holder   |                                  |             |                                 |              |
| Property management, acquisition and development  | \$ 1,280                         | \$          | \$ 1,280                        | \$           |
| Fair value adjustment of obligation associated with Preferred Partnership units   |                                  |             |                                 |              |
| Property management, acquisition and development  | \$ 1,054                         | \$          | \$ 1,054                        | \$           |
| Minority interests - Operating Partnership and other  |                                  |             |                                 |              |
| Property management, acquisition and development  | \$ (756)                         | \$ (306)    | \$ (1,615)                      | \$ (585)     |
| Equity in earnings of real estate ventures  |                                  |             |                                 |              |
| Rental operations   | \$ 1,304                         | \$ 1,340    | \$ 3,693                        | \$ 3,566     |
| Net income (loss)   |                                  |             |                                 |              |
| Property management, acquisition and development  | \$ 423                           | \$ (2,942)  | \$ (1,590)                      | \$ (10,210)  |
| Rental operations   | 10,915                           | 7,249       | 28,093                          | 18,347       |
|   | \$ 11,338                        | \$ 4,307    | \$ 26,503                       | \$ 8,137     |
| <b>Depreciation and amortization expense</b>  |                                  |             |                                 |              |
| Property management, acquisition and development  | \$ 310                           | \$ 225      | \$ 912                          | \$ 608       |
| Rental operations   | 10,288                           | 9,028       | 27,605                          | 26,978       |
|   | \$ 10,598                        | \$ 9,253    | \$ 28,517                       | \$ 27,586    |
| <b>Statement of Cash Flows</b>  |                                  |             |                                 |              |
| Acquisition of real estate assets   |                                  |             |                                 |              |
| Property management, acquisition and development  |                                  |             | \$ (144,347)                    | \$ (127,826) |
| Development and construction of real estate assets  |                                  |             |                                 |              |
| Property management, acquisition and development  |                                  |             | \$ (31,495)                     | \$ (26,301)  |

**20. COMMITMENTS AND CONTINGENCIES**

The Company has guaranteed three construction loans for unconsolidated partnerships that own development properties in Baltimore, Maryland, Chicago, Illinois and Sacramento, California. These properties are owned by joint ventures in which the Company has 10%-50% equity interests. These guarantees were entered into in November 2004, July 2005, and August 2007, respectively. At September 30, 2007, the total amount of guaranteed mortgage debt relating to these joint ventures was \$13,179. These mortgage loans mature December 1, 2007 and July 28, 2008, respectively. If the joint ventures default on the loans, the Company may be forced to repay the loans. Repossessing and/or selling the self-storage facilities and land that collateralize the loans could provide funds sufficient to reimburse the Company. The estimated fair market value of the encumbered assets at September 30, 2007, was \$22,167. The Company has recorded no liability in relation to this guarantee as of September 30, 2007. The fair value of the guarantee is not material. To date, the joint ventures have not defaulted on their mortgage debt. The Company believes the risk of having to perform on the guarantee is remote.

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

**21. INCOME TAXES**

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

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

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

**22. SUBSEQUENT EVENTS**

On October 4, 2007, the Company purchased one property located in California for \$10,775.

**Extra Space Storage Inc.**

**Management's Discussion and Analysis**

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



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

**CAUTIONARY LANGUAGE**

The following discussion and analysis should be read in conjunction with our *Unaudited Condensed Consolidated Financial Statements* and the *Notes to Unaudited Condensed Consolidated Financial Statements* contained in this report and the *Consolidated Financial Statements, Notes to Consolidated Financial Statements* and *Management's Discussion and Analysis of Financial Condition and Results of Operations* contained in our Form 10-K for the year ended December 31, 2006. The Company makes statements in this section that are forward-looking statements within the meaning of the federal securities laws. For a complete discussion of forward-looking statements, see the section in this Form 10-Q entitled *Statement on Forward-Looking Information*. Amounts are in thousands (except per share data and unless otherwise stated).

**CRITICAL ACCOUNTING POLICIES**

Our discussion and analysis of our financial condition and results of operations are based on our unaudited Condensed Consolidated Financial Statements contained elsewhere in this report, which have been prepared in accordance with U.S. generally accepted accounting principles (GAAP). Our notes to the unaudited Condensed Consolidated Financial Statements contained elsewhere in this report and the Audited Consolidated Financial Statements contained in our Form 10-K for the year ended December 31, 2006 describe the significant accounting policies essential to our unaudited Condensed Consolidated Financial Statements. Preparation of our financial statements requires estimates, judgments and assumptions. We believe that the estimates, judgments and assumptions which we have used are appropriate and correct based on information available at the time that they were made. These estimates, judgments and assumptions can affect our reported assets and liabilities as of the date of the financial statements, as well as the reported revenue and expense during the period presented. If there are material differences between these estimates, judgments and assumptions and actual facts, our financial statements may be affected.

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

**RECENT ACCOUNTING PRONOUNCEMENTS**





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

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

## OVERVIEW

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

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

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

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

*Focus on the acquisition of self-storage properties from strategic partners and third parties.* Our acquisitions team will continue to pursue the acquisition of single properties and multi-property portfolios that we believe can provide stockholder value. Our July 2005 acquisition of Storage USA bolstered our reputation as a reliable, ethical buyer, which we believe enhances our ability to negotiate and close acquisitions. In addition, our status as an UPREIT enables flexibility when structuring deals.

*Develop new self-storage properties.* We have several joint venture and wholly-owned development properties and will continue to develop new self-storage properties in our core markets. Our development pipeline for the remainder of 2007 through 2008 includes 17 projects. The majority of the projects will be developed on a wholly-owned basis by the Company. The construction of most of these properties has already begun.

*Expand the Company's management business.* We see the management business as a future acquisition pipeline and expect to pursue strategic relationships with owners that should strengthen our acquisition pipeline through agreements which give us first right of refusal to purchase the managed property in the event of a potential sale. Twelve of the Company's 2006 and 15 of the Company's 2007 acquisitions have come from this channel.

## PROPERTIES

As of September 30, 2007, we owned or had ownership interests in 585 operating self-storage properties located in 33 states and Washington, D.C. Of these properties, 251 are wholly-owned and consolidated, one is held in joint venture and consolidated and 333 are held in joint ventures accounted for using the equity method. In addition, we managed 59 properties for franchisees or third parties bringing the total numbers of properties which we own and/or manage to 644. We receive a management fee of approximately 6% of gross revenues to manage the joint venture, third party and franchise sites. As of September 30, 2007, we owned or had ownership interests in approximately 43 million square feet of space and had greater than 300,000 customers.

Approximately 70% of our properties are clustered around the larger population centers, such as Atlanta, Baltimore/Washington, D.C., Boston, Chicago, Dallas, Houston, Las Vegas, Los Angeles, Miami, New York City, Orlando, Philadelphia, Phoenix, St. Petersburg/Tampa and San Francisco. These markets contain above-average population and income demographics for new self-storage properties. The clustering of assets around these population centers enables us to reduce our operating costs through economies of scale.

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We consider a property to be in the lease-up stage after it has been issued a certificate of occupancy, but before it has achieved stabilization. We consider a property to be stabilized once it has achieved either an 80% occupancy rate for a full year measured as of January 1, or has been open for three years. Although leases are short-term in duration, the typical tenant tends to remain at our properties for an extended period of time. For properties that were stabilized as of September 30, 2007, the median length of stay was approximately eleven months.

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

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

### Stabilized Property Data Based on Location

| Location                | Number of Properties | Actual                                  | Pro forma                            | Actual   | Pro forma                                     | Actual                  | Pro forma               |
|-------------------------|----------------------|---|--------------------------------------|--|---|-------------------------|-------------------------|
|                         |                      | Number of Units as of Sept. 30, 2007(1) | Number of Units as of Sept. 30, 2006 | Net Rentable Square Feet as of Sept. 30, 2007(2) | Net Rentable Square Feet as of Sept. 30, 2006 | Square Foot Occupancy % | Square Foot Occupancy % |
|                         |                      |   |                                      |  |   | Sept. 30, 2007          | Sept. 30, 2006          |
| Wholly-owned properties |                      |   |                                      |  |   |                         |                         |
| Alabama                 | 1                    | 592                                     | 607                                  | 76,105   | 76,135  | 76.4%                   | 71.3%                   |
| Arizona                 | 4                    | 2,263                                   | 2,255                                | 279,540  | 278,670                                       | 94.8%                   | 94.6%                   |
| California              | 41                   | 34,064                                  | 33,923                               | 3,240,997  | 3,226,675                                     | 83.2%                   | 83.8%                   |
| Colorado                | 6                    | 2,944                                   | 2,967                                | 359,741  | 351,491                                       | 87.9%                   | 90.2%                   |
| Connecticut             | 1                    | 745                                     | 745                                  | 62,505   | 62,430  | 86.1%                   | 82.8%                   |
| Florida                 | 27                   | 17,725                                  | 17,694                               | 1,880,350  | 1,874,521                                     | 85.5%                   | 89.6%                   |
| Georgia                 | 12                   | 6,445                                   | 6,474                                | 835,386  | 835,233                                       | 87.5%                   | 87.2%                   |
| Hawaii                  | 2                    | 2,890                                   | 2,860                                | 150,536  | 154,413                                       | 81.4%                   | 82.4%                   |
| Illinois                | 4                    | 2,674                                   | 2,681                                | 263,389  | 264,857                                       | 89.9%                   | 88.2%                   |
| Indiana                 | 1                    | 589                                     | 590                                  | 62,250   | 62,250  | 93.9%                   | 91.8%                   |
| Kansas                  | 1                    | 504                                     | 502                                  | 49,940   | 49,940  | 90.1%                   | 92.3%                   |
| Kentucky                | 3                    | 1,588                                   | 1,579                                | 194,420  | 194,325                                       | 92.8%                   | 90.1%                   |
| Louisiana               | 2                    | 1,407                                   | 1,411                                | 147,690  | 147,690                                       | 89.5%                   | 94.8%                   |
| Maryland                | 9                    | 7,447                                   | 7,377                                | 793,436  | 768,576                                       | 85.8%                   | 83.8%                   |
| Massachusetts           | 24                   | 13,506                                  | 13,458                               | 1,432,706  | 1,428,285                                     | 84.0%                   | 84.1%                   |
| Michigan                | 2                    | 1,040                                   | 1,043                                | 134,882  | 135,312                                       | 87.1%                   | 83.5%                   |
| Missouri                | 6                    | 3,177                                   | 3,169                                | 375,582  | 375,702                                       | 85.9%                   | 86.8%                   |
| Nevada                  | 2                    | 1,255                                   | 1,238                                | 132,565  | 130,655                                       | 84.9%                   | 89.2%                   |
| New Hampshire           | 2                    | 1,007                                   | 1,006                                | 125,909  | 125,609                                       | 80.2%                   | 83.4%                   |
| New Jersey              | 21                   | 17,099                                  | 17,113                               | 1,669,753  | 1,671,116                                     | 85.5%                   | 87.5%                   |
| New Mexico              | 1                    | 503                                     | 534                                  | 61,690   | 67,770  | 89.8%                   | 95.3%                   |
| New York                | 7                    | 6,953                                   | 6,958                                | 456,269  | 455,529                                       | 83.3%                   | 82.7%                   |
| Ohio                    | 4                    | 2,031                                   | 2,046                                | 273,876  | 276,201                                       | 87.4%                   | 88.3%                   |
| Oregon                  | 1                    | 764                                     | 767                                  | 103,450  | 103,610                                       | 89.8%                   | 91.9%                   |
| Pennsylvania            | 8                    | 6,141                                   | 6,135                                | 641,727  | 637,231                                       | 85.7%                   | 84.9%                   |
| Rhode Island            | 1                    | 728                                     | 728                                  | 75,601   | 75,241  | 85.9%                   | 86.1%                   |
| South Carolina          | 4                    | 2,067                                   | 2,068                                | 245,734  | 245,734                                       | 93.0%                   | 93.4%                   |
| Tennessee               | 6                    | 3,533                                   | 3,534                                | 477,227  | 474,512                                       | 84.7%                   | 89.5%                   |
| Texas                   | 19                   | 11,874                                  | 11,959                               | 1,337,314  | 1,322,511                                     | 90.7%                   | 87.1%                   |

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|  |            |                |                |                   |                   |              |              |
|--|------------|----------------|----------------|-------------------|-------------------|--------------|--------------|
| Utah                                     | 3          | 1,533          | 1,529          | 210,540           | 210,140           | 96.2%        | 94.7%        |
| Virginia                                 | 4          | 2,889          | 2,890          | 272,824           | 272,677           | 85.3%        | 84.8%        |
| Washington                               | 3          | 2,031          | 2,030          | 244,865           | 244,595           | 94.6%        | 96.1%        |
| <b>Total Wholly-Owned<br/>Stabilized</b> | <b>232</b> | <b>160,008</b> | <b>159,870</b> | <b>16,668,799</b> | <b>16,599,636</b> | <b>86.2%</b> | <b>86.8%</b> |

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| Location                            | Number of Properties | Actual                                  | Pro forma                            | Actual   | Pro forma                                     | Actual                                 | Pro forma                              |
|-------------------------------------|----------------------|---|--------------------------------------|--|---|--|--|
|                                     |                      | Number of Units as of Sept. 30, 2007(1) | Number of Units as of Sept. 30, 2006 | Net Rentable Square Feet as of Sept. 30, 2007(2) | Net Rentable Square Feet as of Sept. 30, 2006 | Square Foot Occupancy % Sept. 30, 2007 | Square Foot Occupancy % Sept. 30, 2006 |
| Joint-venture properties            |                      |   |                                      |  |   |  |  |
| Alabama                             | 3                    | 1,708                                   | 1,723                                | 205,638  | 205,443                                       | 87.4%                                  | 88.6%                                  |
| Arizona                             | 11                   | 6,897                                   | 6,894                                | 751,156  | 751,266                                       | 91.8%                                  | 93.3%                                  |
| California                          | 72                   | 51,821                                  | 51,868                               | 5,315,985  | 5,317,230                                     | 89.6%                                  | 88.6%                                  |
| Colorado                            | 2                    | 1,335                                   | 1,337                                | 158,263  | 158,113                                       | 84.5%                                  | 85.1%                                  |
| Connecticut                         | 8                    | 5,979                                   | 5,977                                | 690,724  | 689,464                                       | 76.3%                                  | 79.9%                                  |
| Delaware                            | 1                    | 589                                     | 589                                  | 71,655   | 71,655  | 93.5%                                  | 88.6%                                  |
| Florida                             | 24                   | 20,360                                  | 20,338                               | 2,090,368  | 2,079,201                                     | 84.6%                                  | 87.2%                                  |
| Georgia                             | 3                    | 1,887                                   | 1,916                                | 246,406  | 251,530                                       | 86.6%                                  | 83.6%                                  |
| Illinois                            | 6                    | 4,020                                   | 4,026                                | 432,517  | 435,592                                       | 81.5%                                  | 77.0%                                  |
| Indiana                             | 8                    | 3,151                                   | 3,145                                | 406,503  | 406,323                                       | 89.3%                                  | 91.3%                                  |
| Kansas                              | 3                    | 1,214                                   | 1,214                                | 163,030  | 163,900                                       | 85.3%                                  | 90.8%                                  |
| Kentucky                            | 4                    | 2,285                                   | 2,279                                | 268,427  | 268,479                                       | 88.1%                                  | 87.5%                                  |
| Maryland                            | 13                   | 10,224                                  | 10,216                               | 1,013,413  | 1,012,618                                     | 88.2%                                  | 85.4%                                  |
| Massachusetts                       | 16                   | 8,491                                   | 8,550                                | 972,570  | 974,811                                       | 83.6%                                  | 82.9%                                  |
| Michigan                            | 10                   | 5,959                                   | 5,954                                | 783,993  | 785,122                                       | 88.1%                                  | 78.9%                                  |
| Missouri                            | 2                    | 951                                     | 947                                  | 118,195  | 117,935                                       | 88.0%                                  | 75.7%                                  |
| Nevada                              | 7                    | 4,629                                   | 4,643                                | 620,299  | 621,916                                       | 90.5%                                  | 89.4%                                  |
| New Hampshire                       | 3                    | 1,322                                   | 1,324                                | 137,714  | 138,004                                       | 84.4%                                  | 88.9%                                  |
| New Jersey                          | 20                   | 15,150                                  | 15,133                               | 1,593,358  | 1,588,876                                     | 81.7%                                  | 87.8%                                  |
| New Mexico                          | 8                    | 4,198                                   | 4,200                                | 462,160  | 462,644                                       | 84.1%                                  | 84.9%                                  |
| New York                            | 21                   | 22,154                                  | 22,111                               | 1,719,892  | 1,716,170                                     | 88.5%                                  | 85.5%                                  |
| Ohio                                | 11                   | 5,023                                   | 5,032                                | 750,287  | 753,052                                       | 84.6%                                  | 85.0%                                  |
| Oregon                              | 2                    | 1,292                                   | 1,288                                | 137,140  | 137,140                                       | 91.4%                                  | 94.8%                                  |
| Pennsylvania                        | 9                    | 6,472                                   | 6,482                                | 687,858  | 687,420                                       | 85.5%                                  | 84.7%                                  |
| Rhode Island                        | 1                    | 610                                     | 611                                  | 73,880   | 73,905  | 73.6%                                  | 67.3%                                  |
| Tennessee                           | 22                   | 11,817                                  | 11,839                               | 1,548,693  | 1,550,247                                     | 86.8%                                  | 87.0%                                  |
| Texas                               | 18                   | 11,835                                  | 11,856                               | 1,519,536  | 1,518,084                                     | 81.6%                                  | 79.4%                                  |
| Utah                                | 1                    | 520                                     | 522                                  | 59,500   | 59,400  | 94.9%                                  | 89.1%                                  |
| Virginia                            | 15                   | 10,404                                  | 10,380                               | 1,106,550  | 1,106,646                                     | 86.9%                                  | 83.6%                                  |
| Washington                          | 1                    | 551                                     | 551                                  | 62,730   | 62,730  | 94.2%                                  | 89.7%                                  |
| Washington, DC                      | 1                    | 1,536                                   | 1,536                                | 102,003  | 101,990                                       | 92.4%                                  | 87.8%                                  |
| Total Stabilized Joint-Ventures     | 326                  | 224,384                                 | 224,481                              | 24,270,443                                       | 24,266,906                                    | 86.4%                                  | 85.9%                                  |
| Managed properties                  |                      |   |                                      |  |   |  |  |
| California                          | 5                    | 3,272                                   | 3,270                                | 401,555  | 400,355                                       | 79.3%                                  | 82.2%                                  |
| Colorado                            | 1                    | 513                                     | 513                                  | 56,240   | 56,240  | 91.6%                                  | 88.3%                                  |
| Florida                             | 1                    | 572                                     | 569                                  | 56,725   | 56,685  | 94.7%                                  | 96.5%                                  |
| Georgia                             | 7                    | 4,532                                   | 4,555                                | 485,544  | 488,730                                       | 88.4%                                  | 85.6%                                  |
| Maryland                            | 3                    | 3,123                                   | 3,093                                | 256,586  | 256,146                                       | 84.5%                                  | 81.4%                                  |
| Nevada                              | 1                    | 435                                     | 440                                  | 61,235   | 61,235  | 81.2%                                  | 81.0%                                  |
| New Jersey                          | 2                    | 1,098                                   | 1,090                                | 131,472  | 131,542                                       | 91.5%                                  | 90.2%                                  |
| New Mexico                          | 2                    | 1,576                                   | 1,584                                | 171,555  | 171,355                                       | 87.5%                                  | 90.2%                                  |
| Pennsylvania                        | 2                    | 889                                     | 889                                  | 131,130  | 131,330                                       | 92.1%                                  | 87.4%                                  |
| Tennessee                           | 2                    | 1,147                                   | 1,150                                | 135,410  | 135,710                                       | 92.4%                                  | 89.6%                                  |
| Texas                               | 1                    | 371                                     | 371                                  | 46,955   | 46,955  | 99.4%                                  | 98.8%                                  |
| Utah                                | 2                    | 1,434                                   | 1,434                                | 136,477  | 146,687                                       | 87.3%                                  | 78.4%                                  |
| Washington, DC                      | 2                    | 1,255                                   | 1,256                                | 111,759  | 111,809                                       | 85.2%                                  | 83.0%                                  |
| Total Stabilized Managed Properties | 31                   | 20,217                                  | 20,214                               | 2,182,643  | 2,194,779                                     | 86.9%                                  | 85.4%                                  |
| Total Stabilized Properties         | 589                  | 404,609                                 | 404,565                              | 43,121,885                                       | 43,061,321                                    | 86.4%                                  | 86.2%                                  |

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

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

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



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

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|                                      |            | Actual            | Pro forma      | Actual            | Pro forma         | Actual         | Pro forma      |
|--------------------------------------|------------|-------------------|----------------|-------------------|-------------------|----------------|----------------|
|                                      | Number of  | Number of         | Number of      | Net Rentable      | Net Rentable      | Square Foot    | Square Foot    |
| Location                             | Properties | Units as of       | Units as of    | Square Feet as of | Square Feet as of | Occupancy %    | Occupancy %    |
|                                      |            | Sept. 30, 2007(1) | Sept. 30, 2006 | Sept. 30, 2007(2) | Sept. 30, 2006    | Sept. 30, 2007 | Sept. 30, 2006 |
| <b>Wholly-owned properties</b>       |            |                   |                |                   |                   |                |                |
| Arizona                              | 1          | 586               | 599            | 67,375            | 67,375            | 78.2%          | 52.2%          |
| California                           | 5          | 3,639             | 2,787          | 433,850           | 329,960           | 62.6%          | 63.4%          |
| Colorado                             | 1          | 358               | 365            | 58,928            | 60,441            | 84.4%          | 73.1%          |
| Connecticut                          | 1          | 612               | 612            | 60,760            | 60,560            | 77.0%          | 74.0%          |
| Florida                              | 2          | 1,257             | 973            | 157,155           | 133,880           | 76.3%          | 75.7%          |
| Illinois                             | 1          | 592               | 589            | 75,800            | 75,810            | 77.3%          | 68.5%          |
| Massachusetts                        | 4          | 2,898             | 2,292          | 286,237           | 219,303           | 69.9%          | 63.3%          |
| New Jersey                           | 2          | 1,745             | 1,695          | 163,260           | 149,395           | 81.6%          | 81.7%          |
| Pennsylvania                         | 1          | 423               | 425            | 46,910            | 47,410            | 80.8%          | 61.5%          |
| Washington                           | 1          | 506               | 528            | 61,250            | 61,250            | 93.1%          | 86.2%          |
| <b>Total Wholly-Owned Lease-up</b>   | <b>19</b>  | <b>12,616</b>     | <b>10,865</b>  | <b>1,411,525</b>  | <b>1,205,384</b>  | <b>72.8%</b>   | <b>68.8%</b>   |
| <b>Joint-venture properties</b>      |            |                   |                |                   |                   |                |                |
| California                           | 1          | 701               |                | 78,672            |                   | 39.3%          | 0.0%           |
| Illinois                             | 1          | 955               | 957            | 74,153            | 74,558            | 54.4%          | 18.7%          |
| Maryland                             | 1          | 948               | 957            | 73,672            | 73,649            | 57.2%          | 21.3%          |
| New Jersey                           | 2          | 1,196             | 560            | 119,735           | 62,400            | 57.2%          | 76.3%          |
| New Mexico                           | 1          | 495               | 530            | 77,406            | 58,992            | 95.6%          | 93.3%          |
| Pennsylvania                         | 1          | 753               | 767            | 76,496            | 76,773            | 93.6%          | 82.0%          |
| Virginia                             | 1          | 878               | 878            | 84,383            | 84,383            | 82.6%          | 66.3%          |
| <b>Total Lease-up Joint-Ventures</b> | <b>8</b>   | <b>5,926</b>      | <b>4,649</b>   | <b>584,517</b>    | <b>430,755</b>    | <b>68.0%</b>   | <b>58.3%</b>   |
| <b>Managed properties</b>            |            |                   |                |                   |                   |                |                |
| California                           | 8          | 5,425             | 4,793          | 552,315           | 460,915           | 75.7%          | 68.7%          |
| Connecticut                          | 1          | 683               | 696            | 54,840            | 55,260            | 71.7%          | 55.7%          |
| Florida                              | 3          | 2,076             | 1,297          | 224,265           | 112,646           | 61.7%          | 61.7%          |
| Georgia                              | 2          | 974               | 1,029          | 115,265           | 114,740           | 75.3%          | 69.1%          |
| Illinois                             | 2          | 1,562             | 1,575          | 190,399           | 190,509           | 71.9%          | 58.5%          |
| Indiana                              | 1          | 566               | 586            | 68,690            | 68,690            | 83.9%          | 63.5%          |
| Maryland                             | 1          | 727               | 728            | 67,810            | 67,560            | 89.2%          | 75.8%          |
| Massachusetts                        | 4          | 3,847             | 3,864          | 337,234           | 339,454           | 67.5%          | 51.3%          |
| New Jersey                           | 1          | 862               |                | 78,030            |                   | 26.8%          | 0.0%           |
| New York                             | 1          | 1,578             | 1,579          | 116,305           | 116,310           | 79.7%          | 73.3%          |
| Rhode Island                         | 1          | 501               | 506            | 55,670            | 56,095            | 35.5%          | 24.1%          |
| Texas                                | 2          | 1,158             | 1,172          | 125,305           | 124,445           | 86.4%          | 70.2%          |
| Virginia                             | 1          | 687               | 679            | 74,840            | 74,860            | 85.0%          | 75.7%          |
| <b>Total Lease-up Managed</b>        | <b>28</b>  | <b>20,646</b>     | <b>18,504</b>  | <b>2,060,968</b>  | <b>1,781,484</b>  | <b>71.4%</b>   | <b>62.9%</b>   |
| <b>Total Lease-up Properties</b>     | <b>55</b>  | <b>39,188</b>     | <b>34,018</b>  | <b>4,057,010</b>  | <b>3,417,623</b>  | <b>71.4%</b>   | <b>64.4%</b>   |

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

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

RESULTS OF OPERATIONS

**Comparison of the three and nine months ended September 30, 2007 and 2006**

**Overview**

Results for the three and nine months ended September 30, 2007 include the operations of 585 properties (252 of which were consolidated and 333 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, 2006, which included the operations of 561 properties (213 of which were

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consolidated and 348 of which were in joint ventures accounted for using the equity method).

### Revenues

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

|                               | Three months ended<br>September 30, |           |           |          | Nine months ended<br>September 30, |            |           |          |
|-------------------------------|-------------------------------------|-----------|-----------|----------|------------------------------------|------------|-----------|----------|
|                               | 2007                                | 2006      | \$ Change | % Change | 2007                               | 2006       | \$ Change | % Change |
| <b>Revenues:</b>              |                                     |           |           |          |                                    |            |           |          |
| Property rental               | \$ 55,209                           | \$ 44,682 | \$ 10,527 | 23.6%    | \$ 149,832                         | \$ 125,877 | \$ 23,955 | 19.0%    |
| Management and franchise fees | 5,169                               | 5,357     | (188)     | (3.5)%   | 15,520                             | 15,697     | (177)     | (1.1)%   |
| Tenant insurance              | 3,027                               | 716       | 2,311     | 322.8%   | 7,858                              | 2,608      | 5,250     | 201.3%   |
| Development fees              | 97                                  | 47        | 50        | 106.4%   | 334                                | 272        | 62        | 22.8%    |
| Other income                  | 324                                 | 386       | (62)      | (16.1)%  | 608                                | 635        | (27)      | (4.3)%   |
| Total revenues                | \$ 63,826                           | \$ 51,188 | \$ 12,638 | 24.7%    | \$ 174,152                         | \$ 145,089 | \$ 29,063 | 20.0%    |

**Property Rental** The increase in property rental revenue for the three and nine months ended September 30, 2007 consists of \$9,214 and \$18,455, respectively, associated with acquisitions completed in 2007 and 2006, \$825 and \$4,218, respectively, from rate increases at stabilized properties, and \$488 and \$1,282, respectively, from increases in occupancy at lease-up properties.

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

**Tenant Insurance** The increase in tenant insurance revenues is due to the introduction of our captive insurance program at all wholly-owned properties in October 2006. Formerly, insurance revenues included only fee income paid by a third party insurance company. In addition, during the nine months ended September 30, 2007, we promoted the tenant insurance program and successfully increased sales of insurance policies in excess of 40% over the same period in 2006.

### Expenses

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

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|   | Three months ended |           |           |          | Nine months ended |            |           |          |
|---|--------------------|-----------|-----------|----------|-------------------|------------|-----------|----------|
|   | September 30,      |           | \$ Change | % Change | September 30,     |            | \$ Change | % Change |
| Expenses:                                     | 2007               | 2006      |           |          | 2007              | 2006       |           |          |
| Property operations                           | \$ 19,607          | \$ 16,613 | \$ 2,994  | 18.0%    | \$ 53,855         | \$ 46,603  | \$ 7,252  | 15.6%    |
| Tenant insurance                              | 1,397              | 284       | 1,113     | 391.9%   | 3,587             | 1,506      | 2,081     | 138.2%   |
| Unrecovered development and acquisition costs | 184                | (87)      | 271       | (311.5)% | 593               | 255        | 338       | 132.5%   |
| General and administrative                    | 9,326              | 8,598     | 728       | 8.5%     | 27,534            | 26,590     | 944       | 3.6%     |
| Depreciation and amortization                 | 10,598             | 9,253     | 1,345     | 14.5%    | 28,517            | 27,586     | 931       | 3.4%     |
| Total expenses                                | \$ 41,112          | \$ 34,661 | \$ 6,451  | 18.6%    | \$ 114,086        | \$ 102,540 | \$ 11,546 | 11.3%    |

**Property Operations** The increase in property operations expense for the three and nine months ended September 30, 2007 consists of \$2,983 and \$6,040, respectively, associated with acquisitions completed in 2007 and 2006, and \$11 and \$1,212, respectively, from increases in general operating expenses including property taxes and insurance at existing properties.

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

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

**General and Administrative** General and administrative costs remained relatively constant for the periods presented. The slight increase in general and administrative expense is due to additional support personnel being added as a result of our

acquisition and development volume.

**Depreciation and Amortization** Depreciation and amortization expense in the three and nine months ended September 30, 2007 increased due to additional properties being added through acquisition and development. These increases were offset by the customer relationship intangibles related to the Storage USA acquisition being fully amortized in January 2007.

### Other Revenues and Expenses

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

|   | Three months ended<br>September 30, |             |            |          | Nine months ended<br>September 30, |             |            |          |
|---|-------------------------------------|-------------|------------|----------|------------------------------------|-------------|------------|----------|
|   | 2007                                | 2006        | \$ Change  | % Change | 2007                               | 2006        | \$ Change  | % Change |
| <b>Other revenue and expenses:</b>  |                                     |             |            |          |                                    |             |            |          |
| Interest expense  | \$ (16,079)                         | \$ (13,429) | \$ (2,650) | 19.7%    | \$ (44,912)                        | \$ (38,198) | \$ (6,714) | 17.6%    |
| Interest income   | 1,821                               | 175         | 1,646      | 940.6%   | 6,937                              | 805         | 6,132      | 761.7%   |
| Interest income on note<br>receivable from Preferred Unit<br>holder                   | 1,280                               |             | 1,280      | 100.0%   | 1,280                              |             | 1,280      | 100.0%   |
| Equity in earnings of real<br>estate ventures   | 1,304                               | 1,340       | (36)       | (2.7)%   | 3,693                              | 3,566       | 127        | 3.6%     |
| Fair value adjustment of<br>obligation associated with<br>Preferred Partnership units | 1,054                               |             | 1,054      | 100.0%   | 1,054                              |             | 1,054      | 100.0%   |
| Minority interest - Operating<br>Partnership  | (869)                               | (306)       | (563)      | 184.0%   | (1,768)                            | (585)       | (1,183)    | 202.2%   |
| Minority interest - other   | 113                                 |             | 113        | 100.0%   | 153                                |             | 153        | 100.0%   |
| Total other expense   | \$ (11,376)                         | \$ (12,220) | \$ 844     | (6.9)%   | \$ (33,563)                        | \$ (34,412) | \$ 849     | (2.5)%   |

**Interest Expense** The increase in interest expense for the three and nine months ended September 30, 2007 when compared to September 30, 2006 consists of \$888 and \$3,850, respectively, related to new loans on properties acquired in 2007 and 2006, and \$1,340 and \$2,561, respectively, related to increased corporate interest related primarily to the exchangeable senior notes offering in March 2007.

**Interest Income** The increase in interest income was due to the larger amount of cash and short-term investments held during the three and nine months ended September 30, 2007 compared to the prior year. The excess cash was generated primarily by the exchangeable senior notes offering in March 2007.

**Interest Income on note receivable from Preferred Unit holder** Represents interest on a \$100 million loan to the holders of the Preferred OP Units. The funds were loaned on June 25, 2007 and bear interest at 4.85% payable quarterly.

**Equity in Earnings of Real Estate Ventures** The change in equity in earnings of real estate ventures for the three and nine months ended September 30, 2007 relates to increases in income at the properties owned by the real estate ventures. The increases were partially offset by the losses on certain lease-up properties held in joint ventures.

**Fair value adjustment of obligation associated with Preferred Partnership units** This amount is a one-time adjustment that represents the change in fair value of the embedded derivative associated with the Preferred OP Units between the original issuance of the Preferred OP Units (June and August, 2007) and the completion of the amendment to the agreement that was signed on September 28, 2007.

**Minority Interest Operating Partnership** Income allocated to the Operating Partnership represents 7.14% (including the Preferred OP Units) and 8.13% of the net income before minority interest for the nine months ended September 30, 2007 and 2006, respectively. The increase in the amount allocated to the minority interest in 2007 is due to the increase in net income.

#### **Distributions to Preferred Operating Partnership Units**

The fixed distribution to the Preferred OP Units of \$1,510 represents the portion of the distribution related to the \$115.0 million of Preferred OP Units that bears a fixed priority return of 5%. This amount was included on the income statement as a one-time adjustment related to the accounting for the Preferred OP Units prior to the signing of the amended contribution agreement that was filed on September 28, 2007. In future periods, all distributions paid to the Preferred OP Unit holders will be recorded as part of minority interest represented by the Preferred OP Units.

**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 U.S. generally accepted accounting principles ( GAAP ), excluding gains or losses on sales of operating properties, 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 unaudited 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 our liquidity, or as an indicator of our ability to make cash distributions. The following table sets forth the calculation of FFO (dollars are in thousands, except for share data):

|   | Three months ended September 30, |            | Nine months ended September 30, |            |
|---|----------------------------------|------------|---------------------------------|------------|
|   | 2007                             | 2006       | 2007                            | 2006       |
| <b>Net income available to common stockholders</b>  | \$ 9,828                         | \$ 4,307   | \$ 24,993                       | \$ 8,137   |
| Adjustments:  |                                  |            |                                 |            |
| Real estate depreciation  | 8,874                            | 6,945      | 24,290                          | 20,066     |
| Amortization of intangibles   | 1,263                            | 1,944      | 2,877                           | 6,448      |
| Joint venture real estate depreciation and amortization                                   | 1,004                            | 1,144      | 3,091                           | 3,600      |
| Joint venture loss on sale of properties  | 15                               |            | 20                              |            |
| Fair value adjustment of obligation associated with Preferred Operating Partnership units | (1,054)                          |            | (1,054)                         |            |
| Income allocated to Operating Partnership minority interest                               | 869                              | 306        | 1,768                           | 585        |
| <b>Funds from operations</b>  | \$ 20,799                        | \$ 14,646  | \$ 55,985                       | \$ 38,836  |
| <b>Weighted average number of shares - diluted</b>  | 70,567,078                       | 57,072,838 | 69,702,837                      | 56,250,164 |

**SAME-STORE STABILIZED PROPERTY RESULTS**

We consider our same-store stabilized portfolio to consist of only those properties which 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 sets forth operating data for our same-store portfolio. We consider the following same-store presentation to be meaningful in regards to the properties shown below. These results provide information relating to property-level operating changes without the effects of acquisitions or completed developments.



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|  | Three Months Ended |           |  | Percent Change | Nine Months Ended |            |  | Percent Change |
|--|--------------------|-----------|--|----------------|-------------------|------------|--|----------------|
|  | September 30,      |           |  |                | September 30,     |            |  |                |
|  | 2007               | 2006      |  |                | 2007              | 2006       |  |                |
| Same-store rental revenues                         | \$ 40,440          | \$ 39,312 |  | 2.9%           | \$ 118,974        | \$ 114,060 |  | 4.3%           |
| Same-store operating expenses                      | 13,972             | 14,086    |  | (0.8)%         | 41,491            | 40,916     |  | 1.4%           |
| Same-store net operating income                    | 26,468             | 25,226    |  | 4.9%           | 77,483            | 73,144     |  | 5.9%           |
| Non same-store rental revenues                     | 14,769             | 5,370     |  | 175.0%         | 30,858            | 11,817     |  | 161.1%         |
| Non same-store operating expenses                  | 5,635              | 2,527     |  | 123.0%         | 12,364            | 5,687      |  | 117.4%         |
| Total rental revenues                              | 55,209             | 44,682    |  | 23.6%          | 149,832           | 125,877    |  | 19.0%          |
| Total operating expenses                           | 19,607             | 16,613    |  | 18.0%          | 53,855            | 46,603     |  | 15.6%          |
| Same-store square foot occupancy as of quarter end | 86.8%              | 88.0%     |  |                | 86.8%             | 88.0%      |  |                |
| Properties included in same-store                  | 181                | 181       |  |                | 181               | 181        |  |                |

The increase in same-store rental revenues for the three and nine months ended September 30, 2007 was due to our ability to maintain occupancy and increase rental rates to existing customers. The decrease in same-store operating expenses for the three months ended September 30, 2007 was primarily due to decreases in utilities and repairs and maintenance. These decreases were partially offset by increases to property insurance. The increase in same-store operating expenses for the nine months ended September 30, 2007 was primarily due to increases in property taxes and insurance.

## COMMON CONTINGENT SHARES AND COMMON CONTINGENT UNIT PROPERTY PERFORMANCE

As described in the notes to our unaudited Condensed Consolidated Financial Statements, upon the achievement of certain levels of net operating income with respect to 14 of our pre-stabilized properties, our contingent conversion shares ( CCS ) and our Operating Partnership's contingent conversion units ( CCU ) will convert into additional shares of common stock and OP Units, respectively.

As of September 30, 2007, 892,998 CCSs and 45,937 CCUs had converted to common shares and common OP units, respectively. Based on the performance of the properties as of September 30, 2007, an additional 479,730 CCSs and 24,677 CCUs became eligible for conversion. The board of directors approved the conversion of these CCSs and CCUs on November 1, 2007 as per the Company's charter, and the shares and units were issued on November 5, 2007.

The table below outlines the performance of the properties for the three and nine months ended September 30, 2007 and 2006:



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|   | Three Months Ended September 30, |         | Percent | Nine Months Ended September 30, |         | Percent |
|---|----------------------------------|---------|---------|---------------------------------|---------|---------|
|   | 2007                             | 2006    | Change  | 2007                            | 2006    | Change  |
| CCS/CCU rental revenues                         | \$3,094                          | \$2,718 | 13.8%   | \$8,946                         | \$7,608 | 17.6%   |
| CCS/CCU operating expenses                      | 1,341                            | 1,540   | (12.9)% | 3,973                           | 4,195   | (5.3)%  |
| CCS/CCU net operating income                    | 1,753                            | 1,178   | 48.8%   | 4,973                           | 3,413   | 45.7%   |
| Non CCS/CCU rental revenues                     | 52,115                           | 41,964  | 24.2%   | 140,886                         | 118,269 | 19.1%   |
| Non CCS/CCU operating expenses                  | 18,266                           | 15,073  | 21.2%   | 49,882                          | 42,408  | 17.6%   |
| Total rental revenues                           | 55,209                           | 44,682  | 23.6%   | 149,832                         | 125,877 | 19.0%   |
| Total operating expenses                        | 19,607                           | 16,613  | 18.0%   | 53,855                          | 46,603  | 15.6%   |
| CCS/CCU square foot occupancy as of quarter end | 80.8%                            | 75.3%   |         | 80.8%                           | 75.3%   |         |
| Properties included in CCS/CCU                  | 14                               | 14      |         | 14                              | 14      |         |

The increase in CCS/CCU rental revenues for the periods presented was due to increased rental rates and occupancy. The decrease in CCS/CCU operating expenses for the periods presented was due to a decrease in advertising.

### CASH FLOWS

Cash flows provided by operating activities were \$78,852 and \$60,716, respectively, for the nine months ended September 30, 2007 and 2006. The increase in cash provided by operating activities was due primarily to an increase in net income related to the addition of new properties through acquisitions and interest income from short-term investments.

Cash used in investing activities was \$221,007 and \$158,146, respectively, for the nine months ended September 30, 2007 and 2006. The increase is due primarily to the acquisition of properties and the purchase of short-term investments during the nine months ended September 30, 2007.

Cash provided by financing activities was \$113,184 and \$220,463 for the nine months ended September 30, 2007 and 2006, respectively. The financing activities during the nine months ended September 30, 2007 consisted of the issuance of exchangeable senior notes for \$250,000, note receivable issued to a Preferred OP Unit holder of \$100,000, additional net borrowings of \$11,227, and \$44,218 paid in dividends. During the nine months ended September 30, 2006, we issued equity for net proceeds of \$194,901, and had additional net borrowings of \$63,014, offset by \$35,407 paid in dividends.

### OPERATIONAL SUMMARY

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For the three and nine months ended September 30, 2007, we continued our same-store property revenue growth with a revenue increase of 2.9% and 4.3%, respectively, compared to the same periods in 2006. Occupancy at our stabilized properties was fairly consistent on a year-to-year basis, reaching 86.8% as of September 30, 2007 compared to 88.0% as of September 30, 2006.

Property revenue growth was evident in the majority of markets in which we operate. The growth in property revenue is the result of increases in occupancy and rental rates to both new and existing customers. Property expenses increased primarily as a result of increases in property taxes due to re-assessments on properties that we have acquired and other annual tax re-assessments.

### OUTLOOK

In the third quarter, we continued to see a generally positive climate for self-storage in the United States. Rental activity was flat overall when compared with the third quarter of 2006. Despite the lack of increased demand, we were able to raise same-store and overall portfolio revenue through increased rental rates to existing customers. The key economic indicators that affect self-storage demand are mixed, and we continue to look at monthly rental activity as an indicator of demand.

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We seek to drive rental activity and revenue growth by actively managing both pricing and promotional strategies through our revenue management team and utilizing the yield management features of our technology system. In-house training, operational initiatives and marketing promotions continue to be implemented. These activities also provide support for increased rentals at the store level.

Our discounting strategies continue to evolve. Higher levels of discounting were utilized in the first nine months of 2007 compared to 2006. We will selectively discount certain sites and units based on occupancy, availability, and competitive parameters that are controlled through our centralized, real-time technology systems and revenue management team.

Property taxes are a primary driver of expenses for the coming year. As we acquire existing self-storage facilities, tax reassessments will continue to occur. Snow removal expenses, usually a major contributor to expense increases, were lower in the first nine months of 2007 due to lower snowfall amounts in the northeast and mid-Atlantic regions.

We anticipate continued competition from all operators, both public and private, in all of the markets in which we operate. However, we believe that the quality and location of our property portfolio, our revenue management systems, and the strength of our self-storage fundamentals will provide opportunities to grow revenues in the remainder of 2007.

### **LIQUIDITY AND CAPITAL RESOURCES**

As of September 30, 2007, we had \$41,830 available in cash and cash equivalents and \$49,200 in short-term investments. We intend to use this cash to purchase additional self-storage properties and fund other working capital needs during the remainder of 2007. Additionally, 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. Therefore, it is unlikely that we will have any substantial cash balances that could be used to meet our liquidity needs. Instead, these needs must be met from cash generated from operations and external sources of capital.

During September 2004, we, as guarantor, and our Operating Partnership entered into a \$100.0 million revolving line of credit ( Credit Facility ), which included a \$10.0 million swingline subfacility. The Credit Facility was collateralized by self-storage properties. No amounts were outstanding on the line of credit at September 30, 2007 or December 31, 2006 and the Credit Facility expired on September 30, 2007.

On October 19, 2007, we entered into a new \$100.0 million revolving line of credit (the Credit Line ). We intend to use the proceeds of the Credit Line for general corporate purposes and acquisitions. The Credit Line has an interest rate of between 100 and 250 basis points over LIBOR, depending on certain financial ratios of the Company. The Credit Line is collateralized by mortgages on certain real estate assets. As of the closing date, the Credit Line had approximately \$97 million of capacity based on the assets collateralizing the Credit Line. The Credit Line matures October 31, 2010.

As of September 30, 2007, we had approximately \$1.3 billion of debt, resulting in a debt to total capitalization ratio of 54.0%. As of September 30, 2007, the ratio of total fixed rate debt and other instruments to total debt was 92.7%. The weighted average interest rate of the total of fixed and variable rate debt at September 30, 2007 was 5.1%.

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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 covenants at September 30, 2007.

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, short-term investments and borrowings under our Credit Line.

### **Long-Term Liquidity Needs**

Our long-term liquidity needs consist primarily of distributions to stockholders and OP unit holders, new facility development, property acquisitions, principal payments under our borrowings and non-recurring capital expenditures. We do not expect that our operating cash flow will be sufficient to fund our long term liquidity needs and instead expect to fund such needs out of additional borrowings, joint ventures with third parties, and from the proceeds of public and private offerings of equity and debt. We may also use Operating Partnership units as currency to fund acquisitions from self-storage owners who desire tax-deferral in their exiting transactions.

On October 13, 2005, we filed a universal shelf registration statement with the Securities and Exchange Commission, which permits us to sell, from time to time, up to \$800 million of our common stock, preferred stock, depositary shares, warrants and rights to the extent necessary or advisable to meet our liquidity needs. We have issued approximately \$406 million of securities under this shelf registration statement to date, leaving us with availability of approximately \$394 million.

## **FINANCING STRATEGY**

We will continue to employ leverage in our capital structure in amounts determined from time to time by our board of directors. Although our board of directors has not adopted a policy which 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, our board of directors 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 the 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 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.

#### **OFF-BALANCE SHEET ARRANGEMENTS**

Except as disclosed in the notes to our unaudited Condensed Consolidated Financial Statements, we do not currently have any relationships with unconsolidated entities or financial partnerships, such 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 unaudited 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.



Our exchangeable senior notes provide for excess exchange value to be paid in cash or shares of our common stock if our stock price exceeds a certain amount. See the notes to our financial statements for a further description of our exchangeable senior notes.

## CONTRACTUAL OBLIGATIONS

The following table summarizes our contractual obligations as of September 30, 2007:

|   | Total        | Payments due by Period: |            |            |                  |
|---|--------------|-------------------------|------------|------------|------------------|
|   |              | Less Than<br>1 Year     | 1-3 Years  | 4-5 Years  | After<br>5 Years |
| Operating leases  | \$ 62,376    | \$ 5,282                | \$ 10,165  | \$ 8,357   | \$ 38,572        |
| Notes payable, exchangeable senior notes<br>and notes payable to trusts |              |                         |            |            |                  |
| Interest  | 456,847      | 65,041                  | 112,116    | 68,606     | 211,084          |
| Principal   | 1,272,520    | 4,513                   | 423,263    | 82,879     | 761,865          |
| Total contractual obligations   | \$ 1,791,743 | \$ 74,836               | \$ 545,544 | \$ 159,842 | \$ 1,011,521     |

## 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 as of 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

### 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.

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As of September 30, 2007, we had \$1.3 billion in total debt of which \$92.9 million was subject to variable interest rates (including the \$61.8 million on which we have a reverse interest rate swap). If LIBOR were to increase or decrease by 100 basis points, the increase or decrease in interest expense on the variable rate debt would increase or decrease future earnings and cash flows by approximately \$0.9 million 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 significant 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 value of fixed rate notes payable and notes payable to trusts at September 30, 2007 was \$1.2 billion. The carrying value of these fixed rate notes payable at September 30, 2007 was \$1.2 billion.

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

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

We have a disclosure committee to ensure that all disclosures made by the Company to its security holders or the investment community will be accurate and complete and fairly present the Company's 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.

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

### **(ii) 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 litigation and proceedings in the ordinary course of business. We are not a party to any material litigation or legal proceedings, or to the best of our knowledge, any threatened litigation or legal proceedings, which, in the opinion of management, will 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 Part I. Item 1A. Risk Factors in our 2006 Annual Report on Form 10-K. Please refer to that section for disclosures regarding the risks and uncertainties related to our business.

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

As described in the notes to our unaudited Condensed Consolidated Financial Statements, upon the achievement of certain levels of net operating income with respect to 14 of our pre-stabilized properties, our CCSs and our Operating Partnership's CCUs will convert into additional shares of common stock and Operating Partnership units, respectively. Subject to certain lock-up periods and adjustments, the units are generally exchangeable for shares of common stock on a one-for-one basis or an equivalent amount of cash, at the option of the Company.

As of September 30, 2007, 892,998 CCSs and 45,937 CCUs had converted to common shares and common Operating Partnership units, respectively. Based on the performance of the properties as of September 30, 2007, an additional 479,730 CCSs and 24,677 CCUs became eligible for conversion. The board of directors approved the conversion of these CCS and CCUs on November 1, 2007 as per the Company's charter, and the shares and units were issued on November 5, 2007. The shares and units were issued in private placements in reliance on Section 3(a)(9) and Section 4(2) of the Securities Act of 1933, as amended, and the rules and regulations promulgated thereunder. We received no additional consideration for the

conversions.

On August 1, 2007, one property was contributed to the Operating Partnership in exchange for consideration totaling \$14.7 million. Preferred OP Units of 80,905 with a value of \$9.8 million were issued along with cash of approximately \$4.9 million. The units were issued in a private placement in reliance on Section 4(2) of the Securities Act of 1933, as amended, and the rules and regulations promulgated thereunder. Subject to certain lock-up periods and adjustments, the Preferred OP Units will be redeemable at the option of the holder on or after September 1, 2008, which redemption obligation may be satisfied, at the Company's option, in cash or shares of its common stock.

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

None.

### **ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

None

### **ITEM 5. OTHER INFORMATION**

None.

**ITEM 6. EXHIBITS**

Exhibits

- 3.1 Articles of Amendment, dated September 28, 2007 (incorporated by reference to Exhibit 3.1 of Form 8-K filed on October 3, 2007).
- 10.1 First Amendment to Contribution Agreement and to Agreement Regarding Transfer of Series A Units among Extra Space Storage LP, various limited partnerships affiliated with AAAAA Rent-A-Space, H. James Knuppe and Barbara Knuppe, dated September 28, 2007. (incorporated by reference to Exhibit 10.1 of Form 8-K filed on October 3, 2007).
- 10.2 2004 Long Term Incentive Compensation Plan Restricted Stock Award Agreement
- 10.3 First Amendment to Extra Space Storage Inc. 2004 Long Term Incentive Plan
- 10.4 First Amendment to Extra Space Storage Inc. 2004 Non-Employee Directors Share Plan
- 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.

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\* These certifications are being furnished solely to accompany this quarterly report pursuant to 18 U.S.C. Section 1350, and are not being filed for purposes of Section 18 of the Securities Exchange Act of 1934 and are not to be incorporated by reference into any filing of Extra Space Storage Inc., whether made before or after the date hereof, regardless of any general incorporation language in such filing.

**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 7, 2007

/s/ Kenneth M. Woolley  
Kenneth M. Woolley  
*Chairman and Chief Executive Officer*  
*(Principal Executive Officer)*

Date: November 7, 2007

/s/ Kent W. Christensen  
Kent W. Christensen  
*Executive Vice President and Chief Financial Officer*  
*(Principal Financial Officer)*

