Extra Space Storage Inc.
Form 10-Q
August 05, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2016

or

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

For the transition period from to .

Commission File Number: 001-32269

EXTRA SPACE STORAGE INC.
(Exact name of registrant as specified in its charter)

Maryland	20-1076777
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

2795 East Cottonwood Parkway, Suite 400
Salt Lake City, Utah 84121
(Address of principal executive offices)
Registrant’s telephone number, including area code: (801) 365-4600

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

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

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

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

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

The number of shares outstanding of the registrant's common stock, par value $0.01 per share, as of July 31, 2016, was 125,789,327.

EXTRA SPACE STORAGE INC.

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STATEMENT ON FORWARD-LOOKING INFORMATION

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

All forward-looking statements, including without limitation, management’s examination of historical operating trends and estimates of future earnings, are based upon our current expectations and various assumptions. Our expectations, beliefs and projections are expressed in good faith and we believe there is a reasonable basis for them, but there can be no assurance that management’s expectations, beliefs and projections will result or be achieved. All forward-looking statements apply only as of the date made. We undertake no obligation to publicly update or revise forward-looking statements which may be made to reflect events or circumstances after the date made or to reflect the occurrence of unanticipated events.
There are a number of risks and uncertainties that could cause our actual results to differ materially from the forward-looking statements contained in or contemplated by this report. Any forward-looking statements should be considered in light of the risks referenced in “Part II. Item 1A. Risk Factors” below and in “Part I. Item 1A. Risk Factors” included in our most recent Annual Report on Form 10-K. Such factors include, but are not limited to:

- adverse changes in general economic conditions, the real estate industry and the markets in which we operate;
- failure to close pending acquisitions on expected terms, or at all;
- the effect of competition from new and existing stores or other storage alternatives, which could cause rents and occupancy rates to decline;
- difficulties in our ability to evaluate, finance, complete and integrate acquisitions and developments successfully and to lease up those stores, which could adversely affect our profitability;
- potential liability for uninsured losses and environmental contamination;
- the impact of the regulatory environment as well as national, state and local laws and regulations including, without limitation, those governing real estate investment trusts (“REITs”), tenant reinsurance and other aspects of our business, which could adversely affect our results;
- disruptions in credit and financial markets and resulting difficulties in raising capital or obtaining credit at reasonable rates or at all, which could impede our ability to grow;
- increased interest rates and operating costs;
- the failure to effectively manage our growth and expansion into new markets or to successfully operate acquired properties and operations;
- reductions in asset valuations and related impairment charges;
- the failure of our joint venture partners to fulfill their obligations to us or their pursuit of actions that are inconsistent with our objectives;
- the failure to maintain our REIT status for U.S. federal income tax purposes;
- economic uncertainty due to the impact of war or terrorism, which could adversely affect our business plan; and
- difficulties in our ability to attract and retain qualified personnel and management members.

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

	June 30, 2016 (Unaudited)	December 31, 2015
Assets:		
Real estate assets, net	$6,164,787	$5,689,309
Investments in unconsolidated real estate ventures	99,576	103,007
Cash and cash equivalents	41,058	75,799
Restricted cash	15,232	30,738
Receivables from related parties and affiliated real estate joint ventures	485	2,205
Other assets, net	137,860	170,349
Total assets	$6,458,998	$6,071,407
Liabilities, Noncontrolling Interests and Equity:		
Notes payable, net	$2,985,320	$2,758,567
Exchangeable senior notes, net	606,422	623,863
Notes payable to trusts, net	117,258	117,191
Lines of credit	88,000	36,000
Accounts payable and accrued expenses	91,188	82,693
Other liabilities	127,593	80,489
Total liabilities	4,015,781	3,698,803
Commitments and contingencies		
Noncontrolling Interests and Equity:		
Extra Space Storage Inc. stockholders' equity:		
Preferred stock, $0.01 par value, 50,000,000 shares authorized, no shares issued or outstanding	—	—
Common stock, $0.01 par value, 500,000,000 shares authorized, 125,238,660 and 124,119,531 shares issued and outstanding at June 30, 2016 and December 31, 2015, respectively	1,252	1,241
Additional paid-in capital	2,510,744	2,431,754
Accumulated other comprehensive loss	(53,845)	(6,352)
Accumulated deficit	(343,444)	(337,566)
Total Extra Space Storage Inc. stockholders' equity	2,114,707	2,089,077
Noncontrolling interest represented by Preferred Operating Partnership units, net of $120,230 notes receivable	135,167	80,531
Noncontrolling interests in Operating Partnership	193,182	202,834
Other noncontrolling interests	161	162
Total noncontrolling interests and equity	2,443,217	2,372,604
Total liabilities, noncontrolling interests and equity	$6,458,998	$6,071,407

See accompanying notes to unaudited condensed consolidated financial statements.

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

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2016	2015	2016	2015
Revenues:				
Property rental	$211,791	$ 161,024	$411,279	$ 309,918
Tenant reinsurance	21,654	17,340	42,209	33,850
Management fees and other income	10,828	7,496	20,188	15,246
Total revenues	244,273	185,860	473,676	359,014
Expenses:				
Property operations	62,430	48,209	123,542	95,453
Tenant reinsurance	3,941	3,283	8,252	6,211
Acquisition related costs and other	3,138	4,554	7,191	5,423
General and administrative	20,512	16,655	43,914	32,904
Depreciation and amortization	43,950	31,552	86,847	61,980
Total expenses	133,971	104,253	269,746	201,971
Income from operations	110,302	81,607	203,930	157,043
Gain on real estate transactions and earnout from prior acquisition	11,358	400	9,814	400
Interest expense	(32,802)	(22,811)	(64,161)	(44,242)
Non-cash interest expense related to amortization of discount on equity component of exchangeable senior notes	(1,240)	(696)	(2,473)	(1,393)
Interest income	1,625	428	3,339	1,284
Interest income on note receivable from Preferred Operating Partnership unit holder	1,212	1,212	2,425	2,425
Income before equity in earnings of unconsolidated real estate ventures and income tax expense	90,455	60,140	152,874	115,517
Equity in earnings of unconsolidated real estate ventures	3,358	3,001	6,188	5,651
Equity in earnings of unconsolidated real estate ventures - gain on sale of real estate assets and purchase of joint venture partners' interests	—	—	26,923	2,857
Income tax expense	(3,773)	(2,185)	(6,538)	(4,433)
Net income	90,040	60,956	179,447	119,592
Net income allocated to Preferred Operating Partnership noncontrolling interests	(3,434)	(3,007)	(6,614)	(5,933)
Net income allocated to Operating Partnership and other noncontrolling interests	(3,562)	(2,610)	(7,197)	(4,578)
Net income attributable to common stockholders	$83,044	$ 55,339	$165,636	$ 109,081
Earnings per common share				
Basic	$0.66	$ 0.47	$1.33	$ 0.93
Diluted	$0.66	$ 0.47	$1.32	$ 0.92
Weighted average number of shares				
Basic	124,914,467	116,861,678	124,678,293	116,491,710
Diluted	132,025,915	124,475,890	132,152,519	123,477,241
Cash dividends paid per common share	$0.78	$ 0.59	$1.37	$ 1.06

See accompanying notes to unaudited condensed consolidated financial statements.

Extra Space Storage Inc.
Condensed Consolidated Statements of Comprehensive Income
(amounts in thousands)
(unaudited)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2016	2015	2016	2015
Net income	$90,040	$60,956	$179,447	$119,592
Other comprehensive income (loss):				
Change in fair value of interest rate swaps	(18,797)	6,305	(49,945)	(288)
Total comprehensive income	71,243	67,261	129,502	119,304
Less: comprehensive income attributable to noncontrolling interests	6,105	5,941	11,359	10,558
Comprehensive income attributable to common stockholders	$65,138	$61,320	$118,143	$108,746

See accompanying notes to unaudited condensed consolidated financial statements.

Extra Space Storage Inc.
Condensed Consolidated Statement of Noncontrolling Interests and Equity
(amounts in thousands, except share data)
(unaudited)

	Noncontrolling Interests						Extra Space Storage Inc. Stockholders' Equity				
	Preferred Operating Partnership										
	Series A	Series B	Series C	Series D	Operating Partnership	Other	Shares	Par Value	Additional Paid-in Capital	Accumulated Other Comprehensive Loss	Ac De
Balances at December 31, 2015	$14,189	$41,902	$10,730	$13,710	$202,834	$162	124,119,531	$1,241	$2,431,754	$(6,352)	$(
Issuance of common stock upon the exercise of options	—	—	—	—	—	—	22,855	—	313	—	—
Restricted stock grants issued	—	—	—	—	—	—	98,373	—	—	—	—
Restricted stock grants canceled	—	—	—	—	—	—	(5,909)	—	—	—	—
Issuance of common stock, net of offering costs	—	—	—	—	—	—	831,300	9	73,360	—	—
Compensation expense related to stock-based awards	—	—	—	—	—	—	—	—	4,093	—	—
Issuance of Operating Partnership units in conjunction with acquisitions	—	—	—	—	1,405	—	—	—	—	—	—
Redemption of Operating Partnership units for sale of property	—	—	—	—	(7,689)	—	—	—		—	—
Redemption of Operating Partnership units for common stock	—	—	—	—	(829)	—	23,570	—	829	—	—

Issuance of Preferred D Units in the Operating Partnership in conjunction with acquisitions	—	—	—	55,037	—	—	—	—	—	—	—
Repurchase of equity portion of 2013 exchangeable senior notes	—	—	—	—	—	—	148,940	2	(872)	—	—
Net income	3,674	1,257	1,218	465	7,198	(1)	—	—	—	—	16
Other comprehensive income (loss)	(332)	—	—	—	(2,120)	—	—	—	—	(47,493)	—
Tax effect from vesting of restricted stock grants and stock option exercises	—	—	—	—	—	—	—	—	1,267	—	—
Distributions to Operating Partnership units held by noncontrolling interests	(3,742)	(1,258)	(1,218)	(465)	(7,617)	—	—	—	—	—	—
Dividends paid on common stock at $1.37 per share	—	—	—	—	—	—	—	—	—	—	(1
Balances at June 30, 2016	$13,789	$41,901	$10,730	$68,747	$193,182	$161	125,238,660	$1,252	$2,510,744	$(53,845)	$(

See accompanying notes to unaudited condensed consolidated financial statements.

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

	For the Six Months Ended June 30,	
	2016	2015
Cash flows from operating activities:		
Net income	$179,447	$119,592
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	86,847	61,980
Amortization of deferred financing costs	5,617	3,328
Non-cash interest expense related to amortization of discount on equity component of exchangeable senior notes	2,473	1,393
Non-cash interest expense related to amortization of premium on notes payable	(696)	(1,682)
Compensation expense related to stock-based awards	4,093	2,795
Gain on sale of real estate assets and purchase of joint venture partners' interests	(26,923)	(2,857)
Gain on real estate transactions and earnout from prior acquisition	(9,814)	(400)
Distributions from unconsolidated real estate ventures in excess of earnings	1,936	3,459
Changes in operating assets and liabilities:		
Receivables from related parties and affiliated real estate joint ventures	1,720	(1,302)
Other assets	(1,186)	(2,961)
Accounts payable and accrued expenses	(402)	3,857
Other liabilities	(3,442)	(3,915)
Net cash provided by operating activities	239,670	183,287
Cash flows from investing activities:		
Acquisition of real estate assets	(435,298)	(240,892)
Development and redevelopment of real estate assets	(14,400)	(9,926)
Proceeds from sale of real estate assets	17,582	800
Change in restricted cash	15,506	(179)
Investment in unconsolidated real estate ventures	(19,309)	—
Return of investment in unconsolidated real estate ventures	1,318	—
Purchase/issuance of notes receivable	(10,656)	—
Principal payments received from notes receivable	41,393	—
Purchase of equipment and fixtures	(2,128)	(2,592)
Net cash used in investing activities	(405,992)	(252,789)
Cash flows from financing activities:		
Proceeds from the sale of common stock, net of offering costs	73,369	416,643
Repurchase of exchangeable senior notes	(22,192)	—
Proceeds from notes payable and lines of credit	492,880	892,140
Principal payments on notes payable and lines of credit	(222,923)	(973,656)
Deferred financing costs	(5,702)	(3,451)
Net proceeds from exercise of stock options	313	1,102
Proceeds from termination of interest rate cap	1,650	—
Dividends paid on common stock	(171,514)	(123,473)
Distributions to noncontrolling interests	(14,300)	(11,573)
Net cash provided by financing activities	131,581	197,732
Net decrease in cash and cash equivalents	(34,741)	128,230
Cash and cash equivalents, beginning of the period	75,799	47,663

Cash and cash equivalents, end of the period	$41,058	$175,893

	For the Six Months Ended June 30,	
	2016	2015
Supplemental schedule of cash flow information		
Interest paid	$59,676	$40,984
Income taxes paid	8,516	1,431
Supplemental schedule of noncash investing and financing activities:		
Redemption of Operating Partnership units held by noncontrolling interests for common stock:		
Noncontrolling interests in Operating Partnership	$(829)	$(138)
Common stock and paid-in capital	829	138
Tax effect from vesting of restricted stock grants and option exercises		
Other assets	$1,267	$(1,242)
Paid-in capital	(1,267)	1,242
Acquisitions of real estate assets		
Real estate assets, net	$65,960	$122,132
Operating Partnership units issued	(56,237)	(106,522)
Notes payable assumed	(9,723)	—
Receivables from related parties and affiliated real estate joint ventures	—	(15,610)
Accrued construction costs and capital expenditures		
Acquisition of real estate assets	$7,567	$—
Development and redevelopment of real estate assets	1,298	—
Accounts payable and accrued expenses	(8,865)	—
Distribution of real estate from investments in unconsolidated real estate ventures		
Real estate assets, net	$17,261	$—
Investments in unconsolidated real estate ventures	(17,261)	—
Disposition of real estate assets		
Real estate assets, net	$(7,689)	$—
Operating Partnership units redeemed	7,689	—

See accompanying notes to unaudited condensed consolidated financial statements.

EXTRA SPACE STORAGE INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)
Amounts in thousands, except store and share data, unless otherwise stated

1. ORGANIZATION

Extra Space Storage Inc. (the “Company”) is a fully-integrated, self-administered and self-managed real estate investment trust (“REIT”), formed as a Maryland corporation on April 30, 2004, to own, operate, manage, acquire, develop and redevelop professionally managed self-storage properties (“stores”) 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 interests in its stores 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 stores by acquiring wholly-owned stores or by acquiring an equity interest in real estate entities. At June 30, 2016, the Company had direct and indirect equity interests in 1,035 stores. In addition, the Company managed 377 stores for third parties, bringing the total number of stores which it owns and/or manages to 1,412. These stores are located in 37 states, Washington, D.C. and Puerto Rico.

The Company operates in three distinct segments: (1) rental operations; (2) tenant reinsurance; and (3) property management, acquisition and development. The rental operations activities include rental operations of stores in which we have an ownership interest. No single tenant accounts for more than 5.0% of rental income. Tenant reinsurance activities include the reinsurance of risks relating to the loss of goods stored by tenants in the Company’s stores. The Company’s property management, acquisition and development activities include managing, acquiring, developing and selling stores.

2. BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements of the Company are presented on the accrual basis of accounting in accordance with U.S. generally accepted accounting principles (“GAAP”) for interim financial information, and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they may not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (including normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and six months ended June 30, 2016, are not necessarily indicative of results that may be expected for the year ending December 31, 2016. The condensed consolidated balance sheet as of December 31, 2015 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, 2015, as filed with the Securities and Exchange Commission.

Recently Issued Accounting Standards

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2014-09, “Revenue from Contracts with Customers,” which amends the guidance for revenue recognition to replace numerous, industry-specific requirements and converges areas under this topic with those of the International

Financial Reporting Standards. ASU 2014-09 outlines a five-step process for customer contract revenue recognition that focuses on transfer of control, as opposed to transfer of risk and rewards. The amendment also requires enhanced disclosures regarding the nature, amount, timing and uncertainty of revenues and cash flows from contracts with customers. ASU 2014-09 was originally effective for reporting periods beginning after December 15, 2016. Entities can transition to the standard either retrospectively or as a cumulative-effect adjustment as of the date of adoption. In July 2015, the FASB approved a one-year deferral of the effective date of the standard. The new standard will now become effective for annual and interim periods beginning after December 15, 2017 with early adoption on the original effective date permitted. The Company has not yet selected a transition method. The Company is currently assessing the impact of the adoption of ASU 2014-09 on the Company's consolidated financial statements.

In February 2015, the FASB issued ASU 2015-02, "Consolidation (Topic 810): Amendments to the Consolidation Analysis." This guidance is effective for annual reporting periods beginning after December 15, 2015, including interim periods within that reporting period. ASU 2015-02 amends the criteria for determining if a service provider possesses a variable interest in a variable interest entity ("VIE"), and eliminates the presumption that a general partner should consolidate a limited partnership. The Company adopted this guidance effective January 1, 2016. The adoption of this guidance did not have a significant impact on the Company’s condensed consolidated financial statements.

In April 2015, the FASB issued ASU 2015-05, “Intangibles – Goodwill and Other – Internal-Use Software (Subtopic 350-40) – Customers Accounting for Fees Paid in a Cloud Computing Arrangement,” which provides guidance regarding the accounting for fees paid by a customer in cloud computing arrangements. If a cloud computing arrangement includes a software license, the payment of fees should be accounted for in the same manner as the acquisition of other software licenses. If there is no software license, the fees should be accounted for as a service contract. The guidance is effective in fiscal years beginning after December 15, 2015 and early adoption is permitted. An entity can elect to adopt the amendments either (1) prospectively to all arrangements entered into or materially modified after the effective date or (2) retrospectively. The Company adopted this guidance prospectively effective January 1, 2016. The adoption of this guidance did not have a significant impact on the Company’s condensed consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, “Leases (Topic 842),” which requires lessees to recognize the following for all leases (with the exception of short-term leases) at the commencement date: (1) a lease liability, which is a lessee’s obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) a right-of-use asset, which is an asset that represents the lessee’s right to use, or control the use of, a specified asset for the lease term. Lessor accounting is largely unchanged under ASU 2016-02. The guidance is effective for annual and interim periods beginning after December 15, 2018. The Company is currently assessing the impact of the adoption of ASU 2016-02 on the Company’s consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, “Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting.” ASU 2016-09 simplifies several aspects of the accounting for employee share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. This ASU is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. Early adoption is permitted. The Company is currently evaluating the new guidance to determine the impact it may have on its consolidated financial statements.

3. FAIR VALUE DISCLOSURES

Derivative Financial Instruments

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

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

Although the Company has determined that the majority of the inputs used to value its derivatives fall within Level 2 of the fair value hierarchy, the credit valuation adjustments associated with its derivatives utilize Level 3 inputs, such as estimates of current credit spreads to evaluate the likelihood of default by the Company and its counterparties. However, as of June 30, 2016, the Company had assessed the significance of the impact of the credit valuation adjustments on the overall valuation of its derivative positions and determined that the credit valuation adjustments were not significant to the overall valuation of its derivatives. As a result, the Company determined that its derivative valuations in their entirety were classified in Level 2 of the fair value hierarchy.

EXTRA SPACE STORAGE INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)
Amounts in thousands, except store and share data, unless otherwise stated

The table below presents the Company's assets and liabilities measured at fair value on a recurring basis as of June 30, 2016, aggregated by the level in the fair value hierarchy within which those measurements fall.

		Fair Value Measurements at Reporting Date Using		
Description	June 30, 2016	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Other assets - Cash Flow Hedge Swap Agreements	$36	$—	$36	$ —
Other liabilities - Cash Flow Hedge Swap Agreements	$(53,103)	$—	$(53,103)	$ —

The Company did not have any significant assets or liabilities that are re-measured on a recurring basis using significant unobservable inputs as of June 30, 2016 or December 31, 2015.

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

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

When real estate assets are identified by management as held for sale, the Company discontinues depreciating the assets and estimates the fair value of the assets, net of selling costs. If the estimated fair value, net of selling costs, of the assets that have been identified as held for sale is less than the net carrying value of the assets, the Company would recognize a loss on the assets held for sale. The operations of assets held for sale or sold during the period are presented as part of normal operations for all periods presented. As of June 30, 2016, the Company had one store and one parcel of undeveloped land classified as held for sale. The estimated fair value less selling costs of each of these assets is greater than the carrying value of the assets, and therefore no loss has been recorded.

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

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

Fair Value of Financial Instruments

The carrying values of cash and cash equivalents, restricted cash, receivables, other financial instruments included in other assets, accounts payable and accrued expenses, variable-rate notes payable, lines of credit and other liabilities reflected in the condensed consolidated balance sheets at June 30, 2016 and December 31, 2015 approximate fair value.

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

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

	June 30, 2016		December 31, 2015	
	Fair Value	Carrying Value	Fair Value	Carrying Value
Notes receivable from Preferred Operating Partnership unit holders	$131,701	$120,230	$128,216	$120,230
Fixed rate notes receivable	$54,825	$53,593	$86,814	$84,331
Fixed rate notes payable and notes payable to trusts	$2,446,724	$2,367,687	$1,828,486	$1,806,904
Exchangeable senior notes	$760,594	$638,172	$770,523	$660,364

4. EARNINGS PER COMMON SHARE

Basic earnings per common share is computed using the two-class method by dividing net income attributable to common stockholders by the weighted average number of common shares outstanding during the period. All outstanding unvested restricted stock awards contain rights to non-forfeitable dividends and participate in undistributed earnings with common stockholders; accordingly, they are considered participating securities that are included in the two-class method. Diluted earnings per common share measures the performance of the Company over the reporting period while giving effect to all potential common shares that were dilutive and outstanding during the period. The denominator includes the weighted average number of basic shares and the number of additional common shares that would have been outstanding if the potential common shares that were dilutive had been issued, and is calculated using either the two-class, treasury stock or as if-converted method, whichever is most dilutive. Potential common shares are securities (such as options, convertible debt, Series A Participating Redeemable Preferred Units ("Series A Units"), Series B Redeemable Preferred Units ("Series B Units"), Series C Convertible Redeemable Preferred Units ("Series C Units"), Series D Redeemable Preferred Units ("Series D Units") and common Operating Partnership units ("OP Units")) that do not have a current right to participate in earnings of the Company but could do so in the future by virtue of their option, redemption or conversion right.

In computing the dilutive effect of convertible securities, net income is adjusted to add back any changes in earnings in the period associated with the convertible security. The numerator also is adjusted for the effects of any other non-discretionary changes in income or loss that would result from the assumed conversion of those potential common shares. In computing diluted earnings per common share, only potential common shares that are dilutive (those that reduce earnings per common share) are included. For the three months ended June 30, 2016 and 2015, options to purchase approximately 39,564 and 44,207 shares of common stock, respectively, and for the six months ended June 30, 2016 and 2015, options to purchase approximately 28,721 and 32,193 shares of common stock, respectively, were excluded from the computation of earnings per share as their effect would have been anti-dilutive.

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The following table presents the number of Preferred Operating Partnership units, and the potential common shares, that were excluded from the computation of earnings per share as their effect would have been anti-dilutive, assuming full conversion at the average share price for the quarter of $90.31.

	For the Three Months Ended June 30,				For the Six Months Ended June 30,			
	2016		2015		2016		2015	
	Number of Units (1)	Equivalent Shares (if converted)	Number of Units (1)	Equivalent Shares (if converted)	Number of Units (1)	Equivalent Shares (if converted)	Number of Units (1)	Equivalent Shares (if converted)
Series B Units	1,676,087	463,982	1,676,087	618,026	1,676,087	472,670	1,676,087	628,124
Series C Units	704,016	328,193	704,016	437,154	704,016	334,338	704,016	444,297
Series D Units	2,749,857	292,443	548,390	202,209	2,749,857	226,285	548,390	205,513
	5,129,960	1,084,618	2,928,493	1,257,389	5,129,960	1,033,293	2,928,493	1,277,934

(1) Represents the number of units outstanding as of the end of the periods presented.

The Operating Partnership had $63,172 of its 2.375% Exchangeable Senior Notes due 2033 (the “2013 Notes”) issued and outstanding as of June 30, 2016. The 2013 Notes could potentially have a dilutive impact on the Company’s earnings per share calculations. The 2013 Notes are exchangeable by holders into shares of the Company’s common stock under certain circumstances per the terms of the indenture governing the 2013 Notes. The exchange price of the 2013 Notes was $54.63 per share as of June 30, 2016, and could change over time as described in the indenture. The Company has irrevocably agreed to pay only cash for the accreted principal amount of the 2013 Notes relative to its exchange obligations, but retained the right to satisfy the exchange obligation in excess of the accreted principal amount in cash and/or common stock.

The Operating Partnership had $575,000 of its 3.125% Exchangeable Senior Notes due 2035 (the “2015 Notes”) issued and outstanding as of June 30, 2016. The 2015 Notes could potentially have a dilutive impact on the Company’s earnings per share calculations. The 2015 Notes are exchangeable by holders into shares of the Company’s common stock under certain circumstances per the terms of the indenture governing the 2015 Notes. The exchange price of the 2015 Notes was $95.19 per share as of June 30, 2016, and could change over time as described in the indenture. The Company has irrevocably agreed to pay only cash for the accreted principal amount of the 2015 Notes relative to its exchange obligations, but retained the right to satisfy the exchange obligation in excess of the accreted principal amount in cash and/or common stock.

Although the Company has retained the right to satisfy the exchange obligation in excess of the accreted principal amount of the 2013 Notes and 2015 Notes in cash and/or common stock, Accounting Standards Codification (“ASC”) 260, “Earnings per Share,” requires an assumption that shares would be used to pay such exchange obligation, 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. For the three and six months ended June 30, 2016 and 2015, 456,768 and 836,630 shares, respectively, related to the 2013 Notes were included in the computation for diluted earnings per share. For the three and six months ended June 30, 2016, no shares related to the 2015 Notes were included in the computation for diluted earnings per share as the exchange price exceeded the per share price of the Company’s common stock during these periods. For the three and six months ended June 30, 2015, no shares related to the 2015 Notes were included in the computation for diluted earnings per share as the 2015 Notes were not outstanding during these periods.

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

For the purposes of computing the diluted impact on earnings per share of the potential exchange of Series B Units for common shares upon redemption, where the Company has the option to redeem in cash or shares and where the Company has stated the intent and ability to settle the redemption in shares, the Company divided the total value of the Series B Units outstanding as of June 30, 2016 of $41,901 by the closing price of the Company’s common stock as of June 30, 2016 of $92.54 per share. Assuming full exchange for common shares as of June 30, 2016, 452,788 shares would have been issued to the holders of the Series B Units.

For the purposes of computing the diluted impact on earnings per share of the potential exchange of Series C Units for common shares upon redemption, where the Company has the option to redeem in cash or shares and where the Company has stated the intent and ability to settle the redemption in shares, the Company divided the total value of the Series C Units outstanding as of June 30, 2016 of $29,639 by the closing price of the Company's common stock as of June 30, 2016 of $92.54 per share. Assuming full exchange for common shares as of June 30, 2016, 320,283 shares would have been issued to the holders of the Series C Units.

For the purposes of computing the diluted impact on earnings per share of the potential exchange of Series D Units for common shares upon redemption, where the Company has the option to redeem in cash or shares and where the Company has stated the intent and ability to settle the redemption in shares, the Company divided the total value of the Series D Units outstanding as of June 30, 2016 of $68,747 by the closing price of the Company's common stock as of June 30, 2016 of $92.54 per share. Assuming full exchange for common shares as of June 30, 2016, 742,890 shares would have been issued to the holders of the Series D Units.

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

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2016	2015	2016	2015
Net income attributable to common stockholders	$83,044	$ 55,339	$165,636	$ 109,081
Earnings and dividends allocated to participating securities	(214)	(140)	(380)	(259)
Earnings for basic computations	82,830	55,199	165,256	108,822
Earnings and dividends allocated to participating securities	—	—	380	—
Income allocated to noncontrolling interest - Preferred Operating Partnership (Series A Units) and Operating Partnership	5,398	4,276	10,872	7,911
Fixed component of income allocated to noncontrolling interest - Preferred Operating Partnership (Series A Units)	(1,271)	(1,271)	(2,542)	(2,545)
Net income for diluted computations	$86,957	$ 58,204	$173,966	$ 114,188
Weighted average common shares outstanding:				
Average number of common shares outstanding - basic	124,914,467	116,861,678	124,678,293	116,491,710
Series A Units	875,480	875,480	875,480	875,480
OP Units	5,517,607	5,642,737	5,569,537	5,007,835
Unvested restricted stock awards included for treasury stock method	—	—	309,987	—
Shares related to exchangeable senior notes and dilutive stock options	718,361	1,095,995	719,222	1,102,216
Average number of common shares outstanding - diluted	132,025,915	124,475,890	132,152,519	123,477,241
Earnings per common share				
Basic	$0.66	$ 0.47	$1.33	$ 0.93
Diluted	$0.66	$ 0.47	$1.32	$ 0.92

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5. STORE ACQUISITIONS

The following table shows the Company's acquisitions of operating stores for the six months ended June 30, 2016, and does not include purchases of raw land or improvements made to existing assets:

			Consideration Paid						Fair Value
Property Location	Number of Stores	Date of Acquisition	Total	Cash Paid	Loan Assumed	Net Liabilities/(Assets) Assumed	Value of OP Units Issued	Number of OP Units Issued	Real estate assets
Massachusetts	1	6/30/2016	$13,807	$13,751	$—	$ 56	$—	—	$13,807
Georgia	1	6/30/2016	7,993	6,789	—	4	1,200	13,764	7,993
Illinois	4	6/10/2016	55,851	—	—	814	55,037	2,201,467	55,851
Texas	4	6/2/2016	37,478	37,246	—	232	—	—	37,478
South Carolina	1	5/10/2016	8,249	8,230	—	19	—	—	8,249
Washington, DC	1	5/5/2016	32,968	23,163	9,723	82	—	—	32,968
Indiana	5	4/22/2016	26,983	26,849	—	134	—	—	26,983
Colorado	1	4/19/2016	7,904	7,869	—	35	—	—	7,904
Arizona	1	4/18/2016	8,154	8,029	—	125	—	—	8,154
Texas	1	4/15/2016	10,978	10,922	—	56	—	—	10,978
Arizona	1	4/5/2016	5,000	4,999	—	1	—	—	5,000
Hawaii	1	4/5/2016	28,992	28,935	—	57	—	—	28,992
New Mexico	1	3/29/2016	10,958	10,928	—	30	—	—	10,958
New Mexico	1	3/29/2016	17,940	17,905	—	35	—	—	17,940
Georgia	3	3/29/2016	25,087	25,069	—	18	—	—	25,087
Texas	1	3/21/2016	9,994	9,969	—	25	—	—	9,994
Illinois	1	2/25/2016	16,721	16,738	—	(17)	—	—	16,721
Massachusetts	1	2/16/2016	16,169	16,174	—	(5)	—	—	16,169
Florida, Maryland, Nevada, New York, Tennessee (1)	6	2/2/2016	53,898	53,940	—	(42)	—	—	98,082
Texas	3	1/14/2016	22,625	22,523	—	102	—	—	22,625
Florida	1	1/12/2016	9,001	8,980	—	21	—	—	9,001
Texas	3	1/7/2016	27,537	27,435	—	102	—	—	27,537
New Mexico	2	1/7/2016	15,607	15,495	—	112	—	—	15,607
2016 Totals	45		$469,894	$401,938	$ 9,723	$ 1,996	$56,237	2,215,231	$514,078

(1) On February 2, 2016, the Company acquired six stores from its VRS Self Storage LLC joint venture ("VRS") in a step acquisition. The Company owns 45.04% of VRS, with the other 54.96% owned by affiliates of Prudential Real Estate ("Prudential"). VRS created a new subsidiary, Extra Space Properties 122 LLC ("ESP 122") and transferred six stores into ESP 122. VRS then distributed ESP 122 to the Company and Prudential on a pro rata basis. This distribution was accounted for as a spinoff, and was therefore recorded at the net carrying amount of the properties of $17,261. Immediately after the distribution, the Company acquired Prudential's 54.96% interest in ESP 122 for $53,940, resulting in 100% ownership of ESP 122 and the related six stores. Based on the purchase price of Prudential's share of ESP 122, the Company determined that the fair value of its investment in ESP 122

immediately prior to the acquisition of Prudential's share was $44,184, and the Company recorded a gain of $26,923 as a result of re-measuring to fair value its existing equity interest in ESP 122. This gain is included in equity in earnings of unconsolidated real estate ventures - gain on sale of real estate assets and purchase of joint venture partners' interests on the Company's condensed consolidated statements of operations.

Store Dispositions

On April 20, 2016, the Company closed on the sale of seven operating stores located in Ohio and Indiana that had been classified as held for sale for $17,555 in cash. The Company recognized a gain of $11,265 related to this disposition.

On April 1, 2016, the Company disposed of a single store in Texas in exchange for 85,452 of our OP Units valued at $7,689. The Operating Partnership has canceled the OP Units received in this disposition. The Company recognized a gain of $93 related to this disposition.

Losses on Earnout from Prior Acquisition

In December 2014, the Company acquired a portfolio of five stores located in New Jersey and Virginia. As part of this acquisition, the Company agreed to make an additional cash payment to the sellers if the acquired stores exceeded a specified amount of net operating income for the years ending December 31, 2015 and 2016. At the acquisition date, the Company recorded an estimated liability related to this earnout provision. The operating income of these stores during the earnout period has been higher than expected, resulting in an increase in the estimate of the amount due to the sellers of $1,544, which was recorded as a loss and included in loss earnout from prior acquisitions in the Company’s condensed consolidated statements of operations for six months ended June 30, 2016.

6. INVESTMENTS IN UNCONSOLIDATED REAL ESTATE VENTURES

On May 20, 2016, the Company entered into a new joint venture, BH Storage Columbia LLC ("BH"). BH owns a single store located in South Carolina. The Company contributed a total of $1,034 for a 20.0% interest in BH. The Company accounts for its investment in BH under the equity method of accounting.

On April 25, 2016, the Company and Prudential entered into the “Second Amendment to Amended and Restated Operating Agreement of ESS PRISA LLC” and the “First Amendment to Amended and Restated Operating Agreement of ESS PRISA II LLC” (the “Amendments”). The Amendments are deemed effective as of April 1, 2016. Under the Amendments, the Company gave up any future rights to receive distributions from these joint ventures at the higher “excess profit participation” percentage of 17.0% in exchange for a higher equity ownership percentage. The Company’s equity ownership in ESS PRISA LLC increased from 2.0% to 4.0%, and the Company’s equity ownership in ESS PRISA II LLC increased from 2.0% to 4.4%. The Company continues to account for its investment in these joint ventures under the equity method of accounting.

On April 8, 2016, the Company entered into a new joint venture, PR EXR Self Storage, LLC ("PREXR"). PREXR owns a single store located in New York. The Company contributed a total of $12,114 for a 25.0% interest in PREXR. The Company accounts for its investment in PREXR under the equity method of accounting.

On March 31, 2016, the Company entered into a new joint venture, ESS-H Baychester Investments LLC (“Baychester”). Baychester owns a single store in New York. The Company contributed $4,794 for a 44.4% interest in Baychester. The Company accounts for its investment in Baychester under the equity method of accounting.

7. VARIABLE INTERESTS

The Operating Partnership has three wholly-owned unconsolidated subsidiaries (“Trust,” “Trust II” and “Trust III,” together, the “Trusts”) that have issued trust preferred securities to third parties and common securities to the Operating

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

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

Following is a tabular comparison of the assets and liabilities the Company has recorded as a result of its involvement with the Trusts to the maximum exposure to loss the Company is subject to as a result of such involvement as of June 30, 2016:

	Notes payable to Trusts	Investment Balance	Maximum exposure to loss	Difference
Trust	$ 36,083	$ 1,083	$ 35,000	$ —
Trust II	42,269	1,269	41,000	—
Trust III	41,238	1,238	40,000	—
	119,590	3,590	116,000	—
Unamortized debt issuance costs	(2,332)			
	$ 117,258	$ 3,590	$ 116,000	$ —

The Company had no consolidated VIEs during the six months ended June 30, 2016.

8. DERIVATIVES

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

Cash Flow Hedges of Interest Rate Risk

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

The effective portion of changes in the fair value of derivatives designated and that qualify as cash flow hedges is recorded in accumulated other comprehensive income ("OCI") and is subsequently reclassified into earnings in the period that the hedged forecasted transaction affects earnings. A portion of these changes is excluded from accumulated other comprehensive income as it is allocated to noncontrolling interests. During the three and six months ended June 30, 2016 and 2015, such derivatives were used to hedge the variable cash flows associated with existing variable-rate debt. During the remainder of 2016, the Company estimates that an additional $19,368 will be reclassified as an increase to interest expense.

The Company held 30 derivative financial instruments which had a total combined notional amount of $2,058,385 as of June 30, 2016.

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Fair Values of Derivative Instruments

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

	Asset (Liability) Derivatives	
	June 30, 2016	December 31, 2015
Derivatives designated as hedging instruments:	Fair Value	
Other assets	$36	$4,996
Other liabilities	$(53,103)	$(6,991)

Effect of Derivative Instruments

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

	Gain (loss) recognized in OCI For the Three Months Ended June 30,		Location of amounts reclassified from OCI into income	Gain (loss) reclassifed from OCI For the Three Months Ended June 30,	
Type	2016	2015		2016	2015
Swap Agreements	$(23,655)	$3,417	Interest expense	$(4,861)	$(2,636)

	Gain (loss) recognized in OCI For the Six Months Ended June 30,		Location of amounts reclassified from OCI into income	Gain (loss) reclassified from OCI For the Six Months Ended June 30,	
Type	2016	2015		2016	2015
Swap Agreements	$ (58,616)	$ (5,458)	Interest expense	$(9,314)	$(4,933)

Credit-risk-related Contingent Features

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

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

As of June 30, 2016, the fair value of derivatives in a net liability position, which includes accrued interest but excludes any adjustment for nonperformance risk, related to these agreements was $53,103. As of June 30, 2016, the Company had not posted any collateral related to these agreements. If the Company had breached any of these provisions as of June 30, 2016, it could have been required to settle its obligations under the agreements at their termination value of $56,465, including accrued interest.

9. EXCHANGEABLE SENIOR NOTES

In September 2015, the Operating Partnership issued $575,000 of its 3.125% Exchangeable Senior Notes due 2035. Costs incurred to issue the 2015 Notes were approximately $11,992, consisting primarily of a 2% underwriting fee. These costs are being amortized as an adjustment to interest expense over five years, which represents the estimated term based on the first available redemption date, and are included in exchangeable senior notes, net, in the condensed consolidated balance sheets. The 2015 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 April 1, 2016, until the maturity date of October 1, 2035. The Notes bear interest at 3.125% per annum and contain an exchange settlement feature, which provides that the 2015 Notes may, under certain circumstances, be exchangeable for cash (for the principal amount of the 2015 Notes) and, with respect to any excess exchange value, for cash, shares of the Company’s common stock, or a combination of cash and shares of the Company's common stock, at the Company's option. The exchange rate of the 2015 Notes as of June 30, 2016 was approximately 10.51 shares of the Company's common stock per $1,000 principal amount of the 2015 Notes.

The Operating Partnership may redeem the 2015 Notes at any time to preserve the Company's status as a REIT. In addition, on or after October 5, 2020, the Operating Partnership may redeem the 2015 Notes for cash, in whole or in part, at 100% of the principal amount plus accrued and unpaid interest, upon at least 30 days but not more than 60 days prior written notice to the holders of the 2015 Notes. The holders of the 2015 Notes have the right to require the Operating Partnership to repurchase the 2015 Notes for cash, in whole or in part, on October 1 of the years 2020, 2025 and 2030 (unless the Operating Partnership has called the 2015 Notes for redemption), and upon the occurrence of certain designated events, in each case for a repurchase price equal to 100% of the principal amount of the 2015 Notes plus accrued and unpaid interest. Certain events are considered "Events of Default," as defined in the indenture governing the 2015 Notes, which may result in the accelerated maturity of the 2015 Notes.

On June 21, 2013, the Operating Partnership issued $250,000 of its 2.375% Exchangeable Senior Notes due 2033 at a 1.5% discount, or $3,750. Costs incurred to issue the 2013 Notes were approximately $1,672. These costs are being amortized as an adjustment to interest expense over five years, which represents the estimated term based on the first available redemption date, and are included in exchangeable senior notes, net, in the condensed consolidated balance sheets. The 2013 Notes are general unsecured senior obligations of the Operating Partnership and are fully guaranteed by the Company. Interest is payable on January 1 and July 1 of each year beginning January 1, 2014, until the maturity date of July 1, 2033. The 2013 Notes bear interest at 2.375% per annum and contain an exchange settlement feature, which provides that the 2013 Notes may, under certain circumstances, be exchangeable for cash (for the principal amount of the 2013 Notes) and, with respect to any excess exchange value, for cash, shares of the Company's common stock, or a combination of cash and shares of the Company's common stock, at the Company's option. The exchange rate of the 2013 Notes as of June 30, 2016 was approximately 18.30 shares of the Company's common stock per $1,000 principal amount of the 2013 Notes.

The Operating Partnership may redeem the 2013 Notes at any time to preserve the Company's status as a REIT. In addition, on or after July 5, 2018, the Operating Partnership may redeem the 2013 Notes for cash, in whole or in part, at 100% of the principal amount plus accrued and unpaid interest, upon at least 30 days but not more than 60 days prior written notice to the holders of the 2013 Notes. The holders of the 2013 Notes have the right to require the Operating Partnership to repurchase the 2013 Notes for cash, in whole or in part, on July 1 of the years 2018, 2023 and 2028, and upon the occurrence of certain designated events, in each case for a repurchase price equal to 100% of the principal amount of the 2013 Notes plus accrued and unpaid interest. Certain events are considered "Events of Default," as defined in the indenture governing the 2013 Notes, which may result in the accelerated maturity of the 2013 Notes.

Additionally, the 2013 Notes and the 2015 Notes can be exchanged during any calendar quarter, if the last reported sale price of the common stock of the Company is greater than or equal to 130% of the exchange price for at least 20 trading days during a period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter. The price of the Company's common stock exceeded 130% of the exchange price for the required time period for the 2013 Notes during the quarter ended June 30, 2016. Therefore, holders of the 2013 Notes may elect to exchange such notes during the quarter ending September 30, 2016. The price of the Company's common stock did not exceed 130% of the exchange price for the required time period for the 2015 Notes during the quarter ended June 30, 2016.

GAAP requires entities with convertible debt instruments that may be settled entirely or partially in cash upon conversion to separately account for the liability and equity components of the instrument in a manner that reflects the issuer's economic interest cost. The Company therefore accounts for the liability and equity components of the 2013 Notes and 2015 Notes separately. The equity components are included in paid-in capital in stockholders' equity in the condensed consolidated balance sheets, and the value of the equity components are treated as original issue discount for purposes of accounting for the debt components. The discounts are being amortized as interest expense over the remaining period of the debt through its first redemption date: July 1, 2018 for the 2013 Notes, and October 1, 2020 for the 2015 Notes. The effective interest rate on the liability components of both the 2013 Notes and the 2015 Notes is 4.0%, which approximates the market rate of interest of similar debt without exchange features (i.e. nonconvertible debt) at the time of issuance.

EXTRA SPACE STORAGE INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)
Amounts in thousands, except store and share data, unless otherwise stated

Information about the Company's 2013 Notes and 2015 Notes, including the total carrying amounts of the equity components, the principal amounts of the liability components, the unamortized discounts and the net carrying amounts was as follows for the periods indicated:

	June 30, 2016	December 31, 2015
Carrying amount of equity component - 2013 Notes	$—	$—
Carrying amount of equity component - 2015 Notes	22,597	22,597
Carrying amount of equity components	$22,597	$22,597
Principal amount of liability component 2013 Notes	$63,172	$85,364
Principal amount of liability component 2015 Notes	575,000	575,000
Unamortized discount - equity component - 2013 Notes	(1,568)	(2,605)
Unamortized discount - equity component - 2015 Notes	(19,481)	(21,565)
Unamortized cash discount - 2013 Notes	(374)	(633)
Unamortized debt issuance costs	(10,327)	(11,698)
Net carrying amount of liability components	$606,422	$623,863

The amount of interest cost recognized relating to the contractual interest rates and the amortization of the discounts on the liability components of the Notes were as follows for the periods indicated:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2016	2015	2016	2015
Contractual interest	$4,867	$1,484	$9,749	$2,968
Amortization of discount	1,240	696	2,473	1,393
Total interest expense recognized	$6,107	$2,180	$12,222	$4,361

Repurchases of 2013 Notes

During April 2016, the Company repurchased a total principal amount of $2,553 of the 2013 Notes. The Company paid cash for the principal amount and issued a total of 18,031 shares of common stock valued at $1,686 for the exchange value in excess of the principal amount. During February 2016, the Company repurchased a total principal amount of $19,639 of the 2013 Notes. The Company paid cash for the principal amount, and issued a total of 130,909 shares of common stock valued at $11,380 for the exchange value in excess of the principal amount.

The Company allocated the value of the consideration paid to repurchase the 2013 Notes (1) to the extinguishment of the liability component and (2) to the reacquisition of the equity component. The amount allocated to the extinguishment of the liability component is equal to the fair value of that component immediately prior to extinguishment. The difference between the consideration attributed to the extinguishment of the liability component and the sum of (a) the net carrying amount of the repurchased liability component, and (b) the related unamortized debt issuance costs, is recognized as a gain on debt extinguishment. The remaining settlement consideration is allocated to the reacquisition of the equity component of the repurchased 2013 Notes and recognized as a reduction of stockholders' equity.

EXTRA SPACE STORAGE INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)
Amounts in thousands, except store and share data, unless otherwise stated

Information about the repurchases is as follows:

	February 2016	April 2016
Principal amount repurchased	$19,639	$2,553
Amount allocated to:		
Extinguishment of liability component	$18,887	$2,474
Reacquisition of equity component	12,132	1,766
Total consideration paid for repurchase	$31,019	$4,240
Exchangeable senior notes repurchased	$19,639	$2,553
Extinguishment of liability component	(18,887)	(2,474)
Discount on exchangeable senior notes	(716)	(72)
Related debt issuance costs	(36)	(7)
Gain/(loss) on repurchase	$—	$—

10. STOCKHOLDERS’ EQUITY

On August 28, 2015, the Company filed a $400,000 “at the market” equity program with the Securities and Exchange Commission, and entered into separate equity distribution agreements with five sales agents. On May 6, 2016, the Company filed its current $400,000"at the market" equity program with the Securities and Exchange Commission using a new shelf registration statement on Form S-3, and entered into separate equity distribution agreements with six sales agents. Under the terms of the current equity distribution agreements, the Company may from time to time offer and sell shares of common stock, up to the aggregate offering price of $400,000, through its sales agents. The current equity distribution agreements, dated May 6, 2016, replaced and superseded the previous equity distribution agreements, dated August 28, 2015.

During the six months ended June 30, 2016, the Company sold 831,300 shares of common stock under the previous “at the market” equity program at an average sales price of $89.66 per share, resulting in net proceeds of $73,360.

On June 22, 2015, the Company issued and sold 6,325,000 shares of its common stock in a public offering at a price of $68.15 per share. The Company received gross proceeds of $431,049. The underwriting discount and transaction costs were $14,438, resulting in net proceeds of $416,611.

11. NONCONTROLLING INTEREST REPRESENTED BY PREFERRED OPERATING PARTNERSHIP UNITS

Classification of Noncontrolling Interests

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

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

Series A Participating Redeemable Preferred Units
On June 15, 2007, the Operating Partnership entered into a Contribution Agreement with various limited partnerships affiliated with AAAAA Rent-A-Space to acquire ten stores in exchange for 989,980 Series A Units of the Operating Partnership. The stores are located in California and Hawaii.

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

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

On June 25, 2007, the Operating Partnership loaned the holders of the Series A Units $100,000. The note receivable bears interest at 4.85%. During 2013, a loan amendment was signed extending the maturity date to September 1, 2020. The loan is secured by the borrower’s Series A Units. The holders of the Series A Units could redeem up to 114,500 Series A Units prior to the maturity date of the loan. If any redemption in excess of 114,500 Series A Units occurs prior to the maturity date, the holder of the Series A Units is required to repay the loan as of the date of that redemption. On October 3, 2014, the holders of the Series A Units redeemed 114,500 Series A Units for $4,794 in cash and 280,331 shares of common stock. No additional redemption of Series A Units can be made without repayment of the loan. The Series A Units are shown on the balance sheet net of the $100,000 loan because the borrower under the loan receivable is also the holder of the Series A Units.

Series B Redeemable Preferred Units
On April 3, 2014, the Operating Partnership completed the purchase of a store located in Georgia. This store was acquired in exchange for $15,158 of cash and 333,360 Series B Units valued at $8,334.

On August 29, 2013, the Operating Partnership completed the purchase of 19 out of 20 stores affiliated with All Aboard Mini Storage, all of which are located in California. On September 26, 2013, the Operating Partnership completed the purchase of the remaining store. These stores were acquired in exchange for $100,876 of cash (including $98,960 of debt assumed and immediately defeased at closing), 1,342,727 Series B Units valued at $33,568, and 1,448,108 OP Units valued at $62,341.
The Partnership Agreement provides for the designation and issuance of the Series B Units. The Series B Units rank junior to the Series A Units, on parity with the Series C Units and Series D Units, and senior to all other partnership interests of the Operating Partnership with respect to distributions and liquidation.

The outstanding Series B Units have a liquidation value of $25.00 per unit for a fixed liquidation value of $41,902. Holders of the Series B Units receive distributions at an annual rate of 6.0%. These distributions are cumulative. The Series B Units became redeemable at the option of the holder on the first anniversary of the date of issuance, which redemption obligation may be satisfied at the Company’s option in cash or shares of its common stock.

Series C Convertible Redeemable Preferred Units
On November 19, 2013, the Company entered into Contribution Agreements with various entities affiliated with Grupe Properties Co. Inc. (“Grupe”), under which the Company agreed to acquire twelve stores, all of which are located in California. The Company completed the purchase of these stores between December 2013 and May 2014. The

Company previously held 35% interests in five of these stores and a 40% interest in one store through six separate joint ventures with Grupe. These stores were acquired in exchange for a total of approximately $45,722 of cash, the assumption of $37,532 in existing debt, and the issuance of 704,016 Series C Units valued at $30,960.

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

The outstanding Series C Units have a liquidation value of $42.10 per unit for a fixed liquidation value of $29,639. From issuance to the fifth anniversary of issuance, each Series C Unit holder will receive quarterly distributions equal to the quarterly distribution per OP Unit plus $0.18. Beginning on the fifth anniversary of issuance, each Series C Unit holder will receive a fixed quarterly distribution equal to the aggregate quarterly distribution payable in respect of such Series C Unit during the four quarters immediately preceding the fifth anniversary of issuance, divided by four. These distributions are cumulative. The Series C Units became redeemable at the option of the holder one year