

Extra Space Storage Inc.  
Form 10-Q  
August 08, 2008  
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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549**

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**FORM 10-Q**

(Mark One)

☒

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

**For the quarterly period ended June 30, 2008**

**Or**

☐

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

**For the transition period from                      to                      .**

**Commission File Number: 001-32269**

**EXTRA SPACE STORAGE INC.**

(Exact name of registrant as specified in its charter)

**Maryland**

(State or other jurisdiction of incorporation or organization)

**20-1076777**

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

**2795 East Cottonwood Parkway, Suite 400**

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**Salt Lake City, Utah 84121**  
(Address of principal executive offices)

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

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

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

Large accelerated filer ☒

Accelerated filer ☐

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

Smaller reporting company ☐

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

The number of shares outstanding of the registrant's common stock, par value \$0.01 per share, as of July 31, 2008 was 81,934,076.

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EXTRA SPACE STORAGE INC.

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**STATEMENT ON FORWARD-LOOKING INFORMATION**

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

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

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

- changes in general economic conditions and in the markets in which we operate;
- the effect of competition from new self-storage facilities or other storage alternatives, which could cause rents and occupancy rates to decline;
- potential liability for uninsured losses and environmental contamination;
- difficulties in our ability to evaluate, finance and integrate acquired and developed properties into our existing operations and to lease up those properties, which could adversely affect our profitability;
- the impact of the regulatory environment as well as national, state, and local laws and regulations including, without limitation, those governing real estate investment trusts, or REITs, which could increase our expenses and reduce our cash available for distribution;

- recent disruptions in credit and financial markets and resulting difficulties in raising capital at reasonable rates, which could impede our ability to grow;
- delays in the development and construction process, which could adversely affect our profitability; and
- economic uncertainty due to the impact of war or terrorism, which could adversely affect our business plan.

[Table of Contents](#)**PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****Extra Space Storage Inc.****Condensed Consolidated Balance Sheets**  
(in thousands, except share data)

|                                                                                                                                                                             | <b>June 30, 2008</b><br><b>(unaudited)</b> | <b>December 31, 2007</b> |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------|--------------------------|
| <b>Assets:</b>                                                                                                                                                              |                                            |                          |
| Real estate assets:                                                                                                                                                         |                                            |                          |
| Net operating real estate assets                                                                                                                                            | \$ 1,811,327                               | \$ 1,791,377             |
| Real estate under development                                                                                                                                               | 74,127                                     | 49,945                   |
| Net real estate assets                                                                                                                                                      | 1,885,454                                  | 1,841,322                |
| Investments in real estate ventures                                                                                                                                         | 95,819                                     | 95,169                   |
| Cash and cash equivalents                                                                                                                                                   | 185,837                                    | 17,377                   |
| Investments available for sale                                                                                                                                              |                                            | 21,812                   |
| Restricted cash                                                                                                                                                             | 37,152                                     | 34,449                   |
| Receivables from related parties and affiliated real estate joint ventures                                                                                                  | 9,238                                      | 7,386                    |
| Other assets, net                                                                                                                                                           | 35,777                                     | 36,560                   |
| Total assets                                                                                                                                                                | \$ 2,249,277                               | \$ 2,054,075             |
| <b>Liabilities, Minority Interests, and Stockholders' Equity:</b>                                                                                                           |                                            |                          |
| Notes payable                                                                                                                                                               | \$ 931,081                                 | \$ 950,181               |
| Notes payable to trusts                                                                                                                                                     | 119,590                                    | 119,590                  |
| Exchangeable senior notes                                                                                                                                                   | 250,000                                    | 250,000                  |
| Line of credit                                                                                                                                                              |                                            |                          |
| Accounts payable and accrued expenses                                                                                                                                       | 33,609                                     | 31,346                   |
| Other liabilities                                                                                                                                                           | 19,087                                     | 18,055                   |
| Total liabilities                                                                                                                                                           | 1,353,367                                  | 1,369,172                |
| Minority interest represented by Preferred Operating Partnership units, net of \$100,000 note receivable                                                                    | 29,204                                     | 30,041                   |
| Minority interest in Operating Partnership and other minority interests                                                                                                     | 31,238                                     | 34,941                   |
| <b>Commitments and contingencies</b>                                                                                                                                        |                                            |                          |
| <b>Stockholders' equity:</b>                                                                                                                                                |                                            |                          |
| Preferred stock, \$0.01 par value, 50,000,000 shares authorized, no shares issued or outstanding                                                                            |                                            |                          |
| Common stock, \$0.01 par value, 300,000,000 shares authorized, 81,934,549 and 65,784,274 shares issued and outstanding at June 30, 2008 and December 31, 2007, respectively | 819                                        | 658                      |
| Paid-in capital                                                                                                                                                             | 1,061,484                                  | 826,026                  |
| Other comprehensive deficit                                                                                                                                                 |                                            | (1,415)                  |

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|                                                                 |    |           |    |           |
|-----------------------------------------------------------------|----|-----------|----|-----------|
| Accumulated deficit                                             |    | (226,835) |    | (205,348) |
| Total stockholders' equity                                      |    | 835,468   |    | 619,921   |
| Total liabilities, minority interests, and stockholders' equity | \$ | 2,249,277 | \$ | 2,054,075 |

See accompanying notes to unaudited condensed consolidated financial statements.

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

|                                                                                                                                   | <b>Three months ended June 30,</b> |                 | <b>Six months ended June 30,</b> |                  |
|-----------------------------------------------------------------------------------------------------------------------------------|------------------------------------|-----------------|----------------------------------|------------------|
|                                                                                                                                   | <b>2008</b>                        | <b>2007</b>     | <b>2008</b>                      | <b>2007</b>      |
| <b>Revenues:</b>                                                                                                                  |                                    |                 |                                  |                  |
| Property rental                                                                                                                   | \$ 57,885                          | \$ 48,392       | \$ 114,909                       | \$ 94,623        |
| Management and franchise fees                                                                                                     | 5,343                              | 5,143           | 10,420                           | 10,351           |
| Tenant reinsurance                                                                                                                | 3,980                              | 2,688           | 7,458                            | 4,831            |
| Other income                                                                                                                      | 128                                | 327             | 256                              | 521              |
| Total revenues                                                                                                                    | 67,336                             | 56,550          | 133,043                          | 110,326          |
| <b>Expenses:</b>                                                                                                                  |                                    |                 |                                  |                  |
| Property operations                                                                                                               | 20,863                             | 17,352          | 41,504                           | 34,248           |
| Tenant reinsurance                                                                                                                | 1,370                              | 1,217           | 2,532                            | 2,190            |
| Unrecovered development and acquisition costs                                                                                     | 1,428                              | 159             | 1,592                            | 409              |
| General and administrative                                                                                                        | 10,070                             | 8,968           | 20,249                           | 18,208           |
| Depreciation and amortization                                                                                                     | 11,697                             | 9,123           | 23,278                           | 17,919           |
| Total expenses                                                                                                                    | 45,428                             | 36,819          | 89,155                           | 72,974           |
| Income before interest, equity in earnings of real estate ventures, loss on investments available for sale and minority interests | 21,908                             | 19,731          | 43,888                           | 37,352           |
| Interest expense                                                                                                                  | (15,962)                           | (15,437)        | (32,316)                         | (28,833)         |
| Interest income                                                                                                                   | 870                                | 3,668           | 1,295                            | 5,116            |
| Interest income on note receivable from Preferred Unit holder                                                                     | 1,212                              |                 | 2,425                            |                  |
| Equity in earnings of real estate ventures                                                                                        | 1,373                              | 1,192           | 2,595                            | 2,389            |
| Loss on sale of investments available for sale                                                                                    |                                    |                 | (1,415)                          |                  |
| Minority interest - Operating Partnership                                                                                         | (617)                              | (515)           | (1,127)                          | (899)            |
| Minority interests - other                                                                                                        | 117                                | 56              | 256                              | 40               |
| <b>Net income</b>                                                                                                                 | <b>\$ 8,901</b>                    | <b>\$ 8,695</b> | <b>\$ 15,601</b>                 | <b>\$ 15,165</b> |
| <b>Net income per common share</b>                                                                                                |                                    |                 |                                  |                  |
| Basic                                                                                                                             | \$ 0.12                            | \$ 0.13         | \$ 0.22                          | \$ 0.24          |
| Diluted                                                                                                                           | \$ 0.12                            | \$ 0.13         | \$ 0.22                          | \$ 0.23          |
| <b>Weighted average number of shares</b>                                                                                          |                                    |                 |                                  |                  |
| Basic                                                                                                                             | 73,420,540                         | 64,439,138      | 69,554,139                       | 64,356,827       |
| Diluted                                                                                                                           | 79,092,783                         | 69,248,845      | 75,166,645                       | 69,214,313       |
| <b>Cash dividends paid per common share</b>                                                                                       | <b>\$ 0.25</b>                     | <b>\$ 0.23</b>  | <b>\$ 0.50</b>                   | <b>\$ 0.46</b>   |

See accompanying notes to unaudited condensed consolidated financial statements.



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**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>Other<br>Comprehensive<br>Deficit | Accumulated<br>Deficit | Total<br>Stockholders<br>Equity |
|------------------------------------------------------------|------------------------|-----------|--------------------|--------------------------------------------------|------------------------|---------------------------------|
| <b>Balances at December 31, 2007</b>                       | 65,784,274             | \$ 658    | \$ 826,026         | \$ (1,415)                                       | \$ (205,348)           | \$ 619,921                      |
| Issuance of common stock upon the exercise of options      | 67,750                 |           | 872                |                                                  |                        | 872                             |
| Restricted stock grants issued                             | 353,939                | 3         |                    |                                                  |                        | 3                               |
| Restricted stock grants cancelled                          | (2,571)                |           |                    |                                                  |                        |                                 |
| Compensation expense related to stock-based awards         |                        |           | 1,984              |                                                  |                        | 1,984                           |
| Conversion of Contingent Conversion Shares to common stock | 781,157                | 8         |                    |                                                  |                        | 8                               |
| Issuance of common stock, net of offering costs            | 14,950,000             | 150       | 232,568            |                                                  |                        | 232,718                         |
| <b>Comprehensive income</b>                                |                        |           |                    |                                                  |                        |                                 |
| Net income                                                 |                        |           |                    |                                                  | 15,601                 | 15,601                          |
| Loss on sale of investments available for sale             |                        |           |                    | 1,415                                            |                        | 1,415                           |
| Total comprehensive income                                 |                        |           |                    |                                                  |                        | 17,016                          |
| Tax benefit from exercise of common stock options          |                        |           | 34                 |                                                  |                        | 34                              |
| Dividends paid on common stock at \$0.50 per share         |                        |           |                    |                                                  | (37,088)               | (37,088)                        |
| <b>Balances at June 30, 2008</b>                           | 81,934,549             | \$ 819    | \$ 1,061,484       | \$                                               | \$ (226,835)           | \$ 835,468                      |

See accompanying notes to unaudited condensed consolidated financial statements.

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

|                                                                                   | Six months ended June 30,<br>2008 | 2007      |
|-----------------------------------------------------------------------------------|-----------------------------------|-----------|
| <b>Cash flows from operating activities:</b>                                      |                                   |           |
| Net income                                                                        | \$ 15,601                         | \$ 15,165 |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                   |           |
| Depreciation and amortization                                                     | 23,278                            | 17,919    |
| Amortization of deferred financing costs                                          | 1,708                             | 1,560     |
| Loss on investments available for sale                                            | 1,415                             |           |
| Stock compensation expense                                                        | 1,984                             | 875       |
| Income allocated to minority interests                                            | 871                               | 859       |
| Distributions from real estate ventures in excess of earnings                     | 2,400                             | 2,332     |
| Changes in operating assets and liabilities:                                      |                                   |           |
| Receivables from related parties                                                  | (1,852)                           | 7,559     |
| Other assets                                                                      | (525)                             | 3,353     |
| Accounts payable and accrued expenses                                             | 2,263                             | (341)     |
| Other liabilities                                                                 | 1,384                             | 2,624     |
| Net cash provided by operating activities                                         | 48,527                            | 51,905    |
| <b>Cash flows from investing activities:</b>                                      |                                   |           |
| Acquisition of real estate assets                                                 | (37,017)                          | (98,148)  |
| Development and construction of real estate assets                                | (29,532)                          | (19,381)  |
| Proceeds from sale of real estate assets                                          | 340                               |           |
| Investments in real estate ventures                                               | (3,050)                           | (6,022)   |
| Net proceeds from (purchases of) investments available for sale                   | 21,812                            | (90,331)  |
| Change in restricted cash                                                         | (2,703)                           | 8,754     |
| Purchase of equipment and fixtures                                                | (885)                             | (501)     |
| Net cash used in investing activities                                             | (51,035)                          | (205,629) |
| <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           | 3,384                             | 46,147    |
| Principal payments on notes payable and line of credit                            | (22,965)                          | (30,137)  |
| Deferred financing costs                                                          | (542)                             | (6,408)   |
| 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                                      | 232,718                           |           |
| Net proceeds from exercise of stock options                                       | 872                               | 1,033     |
| Dividends paid on common stock                                                    | (37,088)                          | (29,368)  |
| Distributions to Operating Partnership units held by minority interest            | (5,411)                           | (1,779)   |
| Net cash provided by financing activities                                         | 170,968                           | 128,713   |
| Net increase (decrease) in cash and cash equivalents                              | 168,460                           | (25,011)  |
| Cash and cash equivalents, beginning of the period                                | 17,377                            | 70,801    |
| Cash and cash equivalents, end of the period                                      | \$ 185,837                        | \$ 45,790 |

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|                                                                             | Six months ended June 30, |            |
|-----------------------------------------------------------------------------|---------------------------|------------|
|                                                                             | 2008                      | 2007       |
| <b>Supplemental schedule of cash flow information</b>                       |                           |            |
| Interest paid, net of amounts capitalized                                   | \$ 29,678                 | \$ 24,931  |
| <b>Supplemental schedule of noncash investing and financing activities:</b> |                           |            |
| Acquisitions:                                                               |                           |            |
| Real estate assets                                                          | \$                        | \$ 157,079 |
| Notes payable                                                               |                           | (31,010)   |
| Preferred Operating Partnership units                                       |                           | (121,733)  |
| Investment in real estate ventures                                          |                           | (502)      |
| Minority interest in Operating Partnership                                  |                           | (3,834)    |

See accompanying notes to unaudited condensed consolidated financial statements.

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**Extra Space Storage Inc.**

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

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

**1. ORGANIZATION**

Extra Space Storage Inc. (the "Company") is a self-administered and self-managed real estate investment trust ("REIT"), formed as a Maryland corporation on April 30, 2004 to own, operate, manage, acquire 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 (the "Internal Revenue Code"). To the extent the Company continues to qualify as a REIT, it will not be subject to tax, with certain limited exceptions, on the taxable income that is distributed to its stockholders.

The Company invests in self-storage facilities by acquiring or developing wholly-owned facilities or by acquiring an equity interest in real estate entities. At June 30, 2008, the Company had direct and indirect equity interests in 610 storage facilities located in 33 states and Washington, D.C. In addition, the Company managed 63 properties for franchisees and third parties, bringing the total number of properties which it owns and/or manages to 673.

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 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, 2008 are not necessarily indicative of results that may be expected for the year ended December 31, 2008. The Condensed Consolidated Balance Sheet as of December 31, 2007 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, 2007 as filed with the Securities and Exchange Commission ("SEC").

## Reclassifications

Certain amounts in the 2007 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

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

In February 2007, the FASB issued Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* ( FAS 159 ). Under FAS 159, a company may elect to measure eligible financial assets and financial liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings at each subsequent

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reporting date. This statement is effective for fiscal years beginning after November 15, 2007. The Company adopted FAS 159 effective January 1, 2008, but did not elect to measure any additional financial assets or liabilities at fair value.

In December 2007, the FASB issued revised Statement No. 141, *Business Combinations* ( FAS 141(R) ). FAS 141(R) establishes principles and requirements for how an acquirer in a business combination recognizes and measures in its financial statements the assets acquired and liabilities assumed. Generally, assets acquired and liabilities assumed in a transaction will be recorded at the acquisition-date fair value with limited exceptions. FAS 141(R) will also change the accounting treatment and disclosure for certain specific items in a business combination. FAS 141(R) applies proactively to business combinations for which the acquisition date is on or after the beginning of the first fiscal year beginning on or after December 15, 2008. The Company will assess the impact of FAS 141(R) if and when future acquisitions occur. However, the application of FAS 141(R) will result in a significant change in accounting for future acquisitions after the effective date.

In December 2007, the FASB issued Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements - An Amendment of ARB No. 51* ( FAS 160 ). FAS 160 establishes new accounting and reporting standards for the non-controlling interest in a subsidiary and for the deconsolidation of a subsidiary. FAS 160 is effective for fiscal years beginning on or after December 15, 2008. The Company is currently evaluating the impact that FAS 160 will have on its financial statements.

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

In December 2007, the SEC staff issued Staff Accounting Bulletin ( SAB ) No. 110, which is effective January 1, 2008 and amends and replaces SAB No. 107, *Share-Based Payment*. SAB No. 110 expresses the views of the SEC staff regarding the use of a simplified method in developing an estimate of expected term of plain vanilla share options in accordance with SFAS No. 123(R), *Share-Based Payment*. Under the simplified method, the expected term is calculated as the midpoint between the vesting date and the end of the contractual term of the option. The use of the simplified method, which was first described in SAB No. 107, was scheduled to expire on December 31, 2007. SAB No. 110 extends the use of the simplified method for plain vanilla awards in certain situations. The SEC staff does not expect the simplified method to be used when sufficient information regarding exercise behavior, such as historical exercise data or exercise information from external sources, becomes available. The adoption of SAB No. 110 did not have a significant effect on the Company's financial statements.

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

result.

## **Fair Value Disclosures**

### *Assets and Liabilities Measured at Fair Value on a Recurring Basis*

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

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| Description                                  | June 30, 2008 | Fair Value Measurements at Reporting Date Using                         |                                                     |                                                 |
|----------------------------------------------|---------------|-------------------------------------------------------------------------|-----------------------------------------------------|-------------------------------------------------|
|                                              |               | Quoted Prices in<br>Active Markets for<br>Identical Assets<br>(Level 1) | Significant Other<br>Observable Inputs<br>(Level 2) | Significant<br>Unobservable Inputs<br>(Level 3) |
| Notes payable associated with Swap Agreement | (61,770)      |                                                                         |                                                     | (61,770)                                        |
| Other assets - Swap Agreement                | 357           |                                                                         |                                                     | 357                                             |
| Total                                        | \$ (61,413)   | \$                                                                      | \$                                                  | \$ (61,413)                                     |

Following is a reconciliation of the beginning and ending balances for the Company's investments available for sale, which were the Company's only material assets or liabilities that are remeasured on a recurring basis using significant unobservable inputs (Level 3):

|                                             |           |
|---------------------------------------------|-----------|
| Balance as of December 31, 2007             | \$ 21,812 |
| Total gains or losses (realized/unrealized) |           |
| Included in earnings                        | (1,415)   |
| Included in other comprehensive income      | 1,415     |
| Settlements received in cash                | (21,812)  |
| Balance as of June 30, 2008                 | \$        |

Amount of total gains or losses for the period included in earnings attributable to the change in unrealized gains or losses relating to assets still held at June 30, 2008

\$

### *Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis*

Long-lived assets held for use are evaluated for impairment when events or circumstances indicate there may be impairment. When such an event occurs, the Company compares the carrying value of these long-lived assets to the undiscounted future net operating cash flows attributable to the assets. An impairment loss is recorded if the net carrying value of the assets exceeds the undiscounted future net operating cash flows attributable to the asset. The impairment loss recognized equals the excess of net carrying value over the related fair value of the asset. The Company has determined that no property was impaired and therefore no impairment charges were recorded during the three or six months ended June 30, 2008 or 2007.

When real estate assets are identified as held for sale, the Company discontinues depreciating the assets and estimates the fair value of the assets, net of selling costs. If the estimated fair value, net of selling costs, of the assets that have been identified as held for sale is less than the net carrying value of the assets, then a valuation allowance is established. The operations of assets held for sale or sold during the period are presented as discontinued operations for all periods presented. The Company did not have any properties classified as held for sale at June 30, 2008.

The Company assesses whether there are any indicators that the value of its investments in unconsolidated real estate ventures may be impaired when events or circumstances indicate there may be an impairment. An investment is impaired if the Company's estimate of the fair value of the investment is less than its carrying value. To the extent impairment has occurred, and is considered to be other-than-temporary, the loss is measured as the excess of the carrying amount over the fair value of the investment. No impairment charges were recognized for the three or six months ended June 30, 2008 or 2007.

There were no impaired properties or investments in unconsolidated real estate ventures or any real estate assets identified as held for sale during the three or six months ended June 30, 2008. Therefore, the Company did not make any nonrecurring fair value measurements during the period.

### **3. NET INCOME PER SHARE**

Basic earnings per common share is computed by dividing net income by the weighted average number of 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 ( CCSs ), Contingent Conversion Units ( CCUs ), exchangeable Series A Participating Redeemable Preferred Operating Partnership units ( Preferred OP units ) and exchangeable Operating Partnership units ( OP units ) that do not have a current right to participate in earnings but could do so in the future by virtue of their option or conversion right. In computing the dilutive effect of convertible securities, net income 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

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non-discretionary changes in income or loss that would result from the assumed conversion of those potential common shares. In computing diluted earnings per share, only potential common shares that are dilutive, or reduce earnings per share, are included.

The Company's Operating Partnership has \$250,000 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 June 30, 2008, and could change over time as described in the indenture. The price of the Company's common stock did not exceed 130% of the exchange price for the specified period of time during the second quarter of 2008; therefore holders of the exchangeable senior notes may not elect to convert them during the third quarter of 2008.

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, FASB Statement No. 128 *Earnings per Share*, (FAS 128) requires an assumption that shares will be used to pay the exchange obligations in excess of the accreted principal amount, and requires that those shares be included in the Company's calculation of weighted average common shares outstanding for the diluted earnings per share computation. No shares were included in the computation at June 30, 2008 because there was no excess over the accreted principal for the period.

For the purposes of computing the diluted impact on earnings per share of the potential conversion of Preferred OP units into common shares, where the Company has the option to redeem in cash or shares as discussed in Note 15 and where the Company has stated the positive intent and ability to settle at least \$115,000 of the instrument in cash (or net settle a portion of the Preferred OP units against the related outstanding note receivable), only the amount of the instrument in excess of \$115,000 is considered in the calculation of shares contingently issuable for the purposes of computing diluted earnings per share as allowed by paragraph 29 of FAS 128.

For the three months ended June 30, 2008 and 2007, options to purchase 547,392 and 325,934 shares of common stock, and for the six months ended June 30, 2008 and 2007, options to purchase 561,600 and 204,315 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:

|                                                               | <b>Three Months Ended June 30,</b> |             | <b>Six Months Ended June 30,</b> |             |
|---------------------------------------------------------------|------------------------------------|-------------|----------------------------------|-------------|
|                                                               | <b>2008</b>                        | <b>2007</b> | <b>2008</b>                      | <b>2007</b> |
| Net income                                                    | \$ 8,901                           | \$ 8,695    | \$ 15,601                        | \$ 15,165   |
| Add:                                                          |                                    |             |                                  |             |
| Income allocated to minority interest - Operating Partnership | 617                                | 515         | 1,127                            | 899         |
| Net income for diluted computations                           | \$ 9,518                           | \$ 9,210    | \$ 16,728                        | \$ 16,064   |
| Weighted average common shares outstanding:                   |                                    |             |                                  |             |
| Average number of common shares outstanding - basic           | 73,420,540                         | 64,439,138  | 69,554,139                       | 64,356,827  |

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|                                                                     |            |            |            |            |
|---------------------------------------------------------------------|------------|------------|------------|------------|
| Operating Partnership units                                         | 4,090,771  | 4,012,379  | 4,090,771  | 4,012,379  |
| Preferred Operating Partnership units                               | 989,980    | 49,949     | 989,980    | 25,113     |
| Dilutive stock options, restricted stock and<br>CCS/CCU conversions | 591,492    | 747,379    | 531,755    | 819,994    |
| Average number of common shares outstanding -<br>diluted            | 79,092,783 | 69,248,845 | 75,166,645 | 69,214,313 |
| Net income per common share                                         |            |            |            |            |
| Basic                                                               | \$ 0.12    | \$ 0.13    | \$ 0.22    | \$ 0.24    |
| Diluted                                                             | \$ 0.12    | \$ 0.13    | \$ 0.22    | \$ 0.23    |

Table of Contents**4. REAL ESTATE ASSETS**

The components of real estate assets are summarized as follows:

|                                                 | June 30, 2008 | December 31, 2007 |
|-------------------------------------------------|---------------|-------------------|
| Land - operating                                | \$ 419,847    | \$ 411,946        |
| Land - development                              | 63,409        | 52,678            |
| Buildings and improvements                      | 1,443,526     | 1,420,235         |
| Intangible assets - tenant relationships        | 32,340        | 32,173            |
| Intangible lease rights                         | 6,150         | 6,150             |
|                                                 | 1,965,272     | 1,923,182         |
| Less: accumulated depreciation and amortization | (153,945)     | (131,805)         |
| Net operating real estate assets                | 1,811,327     | 1,791,377         |
| Real estate under development                   | 74,127        | 49,945            |
| Net real estate assets                          | \$ 1,885,454  | \$ 1,841,322      |

On June 19, 2008, the Company sold an undeveloped parcel of vacant land in Antelope, California for its book value of \$340. There was no gain or loss recognized on the sale.

**5. PROPERTY ACQUISITIONS**

The following table shows the Company's acquisitions of operating properties for the six months ended June 30, 2008, and does not include purchases of raw land or improvements made to existing assets:

| Property Location(s) | Number of Properties | Date of Acquisition | Total Consideration | Cash Paid | Net Liabilities / (Assets) Assumed | Source of Acquisition |
|----------------------|----------------------|---------------------|---------------------|-----------|------------------------------------|-----------------------|
| Florida              | 1                    | 6/19/08             | \$ 10,239           | \$ 10,317 | \$ (78)                            | Unrelated third party |
| California           | 1                    | 5/2/08              | 7,759               | 7,744     | 15                                 | Unrelated third party |
| Total                | 2                    |                     | \$ 17,998           | \$ 18,061 | \$ (63)                            |                       |

**6. INVESTMENTS IN REAL ESTATE VENTURES**

Investments in real estate ventures consisted of the following:

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|                                                                   | Equity<br>Ownership % | Excess Profit<br>Participation % | Investment balance at |                   |
|-------------------------------------------------------------------|-----------------------|----------------------------------|-----------------------|-------------------|
|                                                                   |                       |                                  | June 30, 2008         | December 31, 2007 |
| Extra Space West One LLC ( ESW )                                  | 5%                    | 40%                              | \$ 1,665              | \$ 1,804          |
| Extra Space West Two LLC ( ESW II )                               | 5%                    | 40%                              | 4,943                 | 5,019             |
| Extra Space Northern Properties Six, LLC ( ESNPS )                | 10%                   | 35%                              | 1,546                 | 1,642             |
| Extra Space of Santa Monica LLC ( ESSM )                          | 41%                   | 41%                              | 5,244                 | 5,138             |
| Clarendon Storage Associates Limited Partnership<br>( Clarendon ) | 50%                   | 50%                              | 4,197                 | 4,189             |
| PRISA Self Storage LLC ( PRISA )                                  | 2%                    | 17%                              | 12,601                | 12,732            |
| PRISA II Self Storage LLC ( PRISA II )                            | 2%                    | 17%                              | 10,537                | 10,608            |
| PRISA III Self Storage LLC ( PRISA III )                          | 5%                    | 20%                              | 4,251                 | 4,405             |
| VRS Self Storage LLC ( VRS )                                      | 5%                    | 20%                              | 4,468                 | 4,515             |
| WCOT Self Storage LLC ( WCOT )                                    | 5%                    | 20%                              | 5,349                 | 5,211             |
| Storage Portfolio I, LLC ( SP I )                                 | 25%                   | 40%                              | 17,975                | 18,567            |
| Storage Portfolio Bravo II ( SPB II )                             | 20%                   | 25-45%                           | 14,451                | 14,785            |
| U-Storage de Mexico S.A. and related entities<br>( U-Storage )    | 35-40%                | 35-40%                           | 7,491                 | 4,891             |
| Other minority owned properties                                   | 10-50%                | 10-50%                           | 1,101                 | 1,663             |
|                                                                   |                       |                                  | \$ 95,819             | \$ 95,169         |

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.

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

|                                                                | Three months ended June 30, |          | Six months ended June 30, |          |
|----------------------------------------------------------------|-----------------------------|----------|---------------------------|----------|
|                                                                | 2008                        | 2007     | 2008                      | 2007     |
| Equity in earnings of ESW                                      | \$ 371                      | \$ 348   | \$ 693                    | \$ 696   |
| Equity in earnings (losses) of ESW II                          | (21)                        |          | (38)                      |          |
| Equity in earnings of ESNPS                                    | 64                          | 41       | 119                       | 87       |
| Equity in earnings of Clarendon                                | 98                          | 104      | 189                       | 201      |
| Equity in earnings of PRISA                                    | 169                         | 185      | 346                       | 355      |
| Equity in earnings of PRISA II                                 | 148                         | 147      | 296                       | 277      |
| Equity in earnings of PRISA III                                | 55                          | 71       | 126                       | 134      |
| Equity in earnings of VRS                                      | 67                          | 62       | 131                       | 123      |
| Equity in earnings of WCOT                                     | 72                          | 77       | 147                       | 147      |
| Equity in earnings of SP I                                     | 293                         | 248      | 553                       | 453      |
| Equity in earnings of SPB II                                   | 149                         | 181      | 321                       | 371      |
| Equity in earnings (losses) of U-Storage                       | (43)                        |          | (116)                     |          |
| Equity in earnings (losses) of other minority owned properties | (49)                        | (272)    | (172)                     | (455)    |
|                                                                | \$ 1,373                    | \$ 1,192 | \$ 2,595                  | \$ 2,389 |

Equity in earnings (losses) of ESW II, SP I and SPB II include the amortization of the Company's excess purchase price of \$25,515 of these equity investments over its original basis. The excess basis is amortized over 40 years.

## 7. INVESTMENTS AVAILABLE FOR SALE

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 the fair value of available for sale securities are recorded as a component of other comprehensive income (loss). A decline in the market value of equity 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. The Company's investments available for sale have generally consisted of non mortgage-backed auction rate securities (ARS). ARS are generally long-term debt instruments that provide liquidity through a Dutch auction process that resets the applicable interest rate at pre-determined calendar intervals, generally every 28 days. This mechanism allows existing investors to rollover their holdings and continue to own their respective securities or liquidate their holding by selling their securities at par.

Uncertainties in the credit markets had prevented the Company and other investors from liquidating their holdings of ARS in auctions for these securities because the amount of securities submitted for sale exceeded the amount of purchase orders. As a result, during the year ended December 31, 2007, the Company recognized an other-than-temporary impairment charge of \$1,213 and temporary impairment charge of \$1,415, which reduced the carrying value of the Company's investments in ARS to \$21,812 as of December 31, 2007. On February 29, 2008, the Company liquidated its holdings of ARS for \$21,812 in cash. As a result of this settlement, the Company recognized \$1,415 of the amount that was previously classified as a temporary impairment as loss on sale of investments available for sale through earnings. The Company had no investments in ARS as of June 30, 2008.

**8. OTHER ASSETS**

The components of other assets are summarized as follows:

|                                  | <b>June 30, 2008</b> | <b>December 31, 2007</b> |
|----------------------------------|----------------------|--------------------------|
| Equipment and fixtures           | \$ 12,784            | \$ 11,899                |
| Less: accumulated depreciation   | (9,401)              | (8,364)                  |
| Deferred financing costs, net    | 14,345               | 15,534                   |
| Prepaid expenses and deposits    | 5,109                | 5,162                    |
| Accounts receivable, net         | 7,885                | 8,516                    |
| Fair value of interest rate swap | 357                  |                          |
| Investments in Trusts            | 3,590                | 3,590                    |
| Other                            | 1,108                | 223                      |
|                                  | \$ 35,777            | \$ 36,560                |

Table of Contents**9. NOTES PAYABLE**

The components of notes payable are summarized as follows:

|                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       | June 30, 2008 | December 31, 2007 |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------|-------------------|
| <b>Fixed Rate</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     |               |                   |
| Mortgage and construction loans with banks bearing interest at fixed rates between 4.65% and 7.0%. 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 April 1, 2009 and February 11, 2017.                                                                                                                                                                                                                                                                         | \$ 820,472    | \$ 825,326        |
| <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 based on LIBOR are between LIBOR plus 0.66% (3.12% and 5.26% at June 30, 2008 and December 31, 2007, respectively) and LIBOR plus 2.25% (4.71% and 6.85% at June 30, 2008 and December 31, 2007, 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 June 30, 2011. | 110,609       | 124,855           |
|                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       | \$ 931,081    | \$ 950,181        |

Real estate assets are pledged as collateral for the notes payable. The Company is subject to certain restrictive covenants relating to the outstanding notes payable. The Company was in compliance with all covenants at June 30, 2008.

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 0.66%. 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 June 30, 2008 was reflected as an other asset of \$357. The estimated fair value of the Swap Agreement at December 31, 2007 was reflected as an other liability of \$125. The fair value of the Swap Agreement is determined through observable prices in active markets for identical agreements. The Company recorded a reduction to interest expense relating to the Swap Agreement of \$119 for the three months ended June 30, 2008 and additional interest expense of \$264 for the three months ended June 30, 2007. Interest expense was decreased by \$7 for the six months ended June 30, 2008 and interest expense was increased by \$525 for the six months ended June 30, 2007.

On August 31, 2007, as part of the acquisition of a 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 rates 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

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1/1/2007 to 12/31/2007 and 5.48% from 1/1/2008 through 12/31/2008) on \$23,340 of floating rate debt to be offset by the value of the interest rate cap agreement. The estimated fair value of the interest rate cap at the assumption date was not material and no asset or liability was recorded. The fair value of the interest rate cap at June 30, 2008 and December 31, 2007 was also not material. The fair value of the interest rate cap is determined through observable prices in active markets for identical agreements.

On June 30, 2008, the Company entered into a loan agreement in the amount of \$64,530 secured by certain properties. On June 30, 2008, \$1,000 was drawn on the loan balance. As part of the loan agreement, the Company agreed to draw down at least 50% of the loan amount by February 1, 2009 with the remainder to be drawn by March 31, 2009. The loan bears interest at LIBOR plus 2%, maturing on June 30, 2011.

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## 10. NOTES PAYABLE TO TRUSTS

During July 2005, ESS Statutory Trust III (the Trust III), a newly formed Delaware statutory trust and a wholly-owned, unconsolidated subsidiary of the Operating Partnership, issued an aggregate of \$40,000 of preferred securities which mature on July 31, 2035. In addition, the Trust III issued 1,238 of Trust common securities to the Operating Partnership for a purchase price of \$1,238. On July 27, 2005, the proceeds from the sale of the preferred and common securities of \$41,238 were loaned in the form of a note to the Operating Partnership (Note 3). Note 3 has a fixed rate of 6.91% through July 31, 2010, and then will be payable at a variable rate equal to the three-month LIBOR plus 2.40% per annum. The interest on Note 3, payable quarterly, will be used by the Trust III to pay dividends on the trust preferred securities. The trust preferred securities may be redeemed by the Trust with no prepayment premium after July 27, 2010.

During May 2005, ESS Statutory Trust II (the Trust II), a newly formed Delaware statutory trust and a wholly-owned, unconsolidated subsidiary of the Operating Partnership, issued an aggregate of \$41,000 of preferred securities which mature on June 30, 2035. In addition, the Trust II issued 1,269 of Trust common securities to the Operating Partnership for a purchase price of \$1,269. On May 24, 2005, the proceeds from the sale of the preferred and common securities of \$42,269 were loaned in the form of a note to the Operating Partnership (Note 2). Note 2 has a fixed rate of 6.67% through June 30, 2010, and then will be payable at a variable rate equal to the three-month LIBOR plus 2.40% per annum. The interest on Note 2, payable quarterly, will be used by the Trust II to pay dividends on the trust preferred securities. The trust preferred securities may be redeemed by the Trust with no prepayment premium after June 30, 2010.

During April 2005, ESS Statutory Trust I (the Trust I), a newly formed Delaware statutory trust and a wholly-owned, unconsolidated subsidiary of the Operating Partnership issued an aggregate of \$35,000 of trust preferred securities which mature on June 30, 2035. In addition, the Trust issued 1,083 of trust common securities to the Operating Partnership for a purchase price of \$1,083. On April 8, 2005, the proceeds from the sale of the trust preferred and common securities of \$36,083 were loaned in the form of a note to the Operating Partnership (the Note). The Note has a variable rate equal to the three-month LIBOR plus 2.25% per annum. The interest on the Note, payable quarterly, will be used by the Trust to pay dividends on the trust preferred securities. The trust preferred securities may be redeemed by the Trust with no prepayment premium after June 30, 2010.

The Company follows FASB Interpretation No. 46R, *Consolidation of Variable Interest Entities* (FIN 46R), which addresses the consolidation of 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 \$250,000 of its 3.625% Exchangeable Senior Notes due April 1, 2027 (the Notes). Costs incurred to issue the Notes were approximately \$5,100. These costs are being amortized over five years, which represents the estimated term of the Notes, and are included in other assets in the condensed consolidated balance sheet as of June 30, 2008. The Notes are general unsecured senior obligations of the Operating Partnership and are fully guaranteed by the Company. Interest is payable on April 1 and October 1 of each year until the maturity date of April 1, 2027. The Notes bear interest at 3.625% per annum and contain an exchange settlement feature, which provides that the Notes may, under certain circumstances, be exchangeable for cash (up to the principal amount of the Notes) and, with respect to any excess exchange value, for cash, shares of our common stock or a combination of cash and shares of our common stock at an initial exchange rate of approximately 42.5822 shares per one thousand dollars principal amount of Notes at the option of the Operating Partnership.

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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 FASB Statement No. 133: *Accounting for Derivative Instruments and Hedging Activities* (FAS 133), EITF Issue 90-19:

*Convertible Bonds with Issuer Option to Settle for Cash Upon Conversion*, and EITF Issue No. 01-6: *The Meaning of Indexed to a Company's Own Stock* that would require bifurcation (i.e. separate accounting of the note and the exchange settlement feature). The Company has concluded that the exchange settlement feature has satisfied the exemption in FAS 133 because it is indexed to the Company's own common stock and would otherwise be classified in stockholders' equity, among other

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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 exchange settlement feature.

**12. LINE OF CREDIT**

On October 19, 2007, the Operating Partnership entered into a \$100,000 revolving line of credit (the Credit Line) that matures October 31, 2010. 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 205 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 June 30, 2008, the Credit Line had \$100,000 of capacity based on the assets collateralizing the Credit Line. No amounts were outstanding on the Credit Line at June 30, 2008 or December 31, 2007. The Company is subject to certain restrictive covenants relating to the Credit Line. The Company was in compliance with all covenants as of June 30, 2008.

**13. OTHER LIABILITIES**

The components of other liabilities are summarized as follows:

|                                  | June 30, 2008 | December 31, 2007 |
|----------------------------------|---------------|-------------------|
| Deferred rental income           | \$ 12,634     | \$ 11,805         |
| Security deposits                | 347           | 383               |
| SUSA lease obligation liability  | 2,726         | 2,592             |
| Fair value of interest rate swap |               | 125               |
| Other miscellaneous liabilities  | 3,380         | 3,150             |
|                                  | \$ 19,087     | \$ 18,055         |

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

The Company provides management and development services for certain joint ventures, franchises, third parties and other related party properties. Management agreements provide generally for management fees of 6% of cash collected from properties for the management of operations at the self-storage facilities. Management fee revenues for related parties and affiliated real estate joint ventures are summarized as follows:

| Entity | Type                                  | Three months ended June 30, 2008 | Three months ended June 30, 2007 | Six months ended June 30, 2008 | Six months ended June 30, 2007 |
|--------|---------------------------------------|----------------------------------|----------------------------------|--------------------------------|--------------------------------|
| ESW    | Affiliated real estate joint ventures | \$ 110                           | \$ 109                           | \$ 218                         | \$ 218                         |

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|           |                                       |          |          |        |        |
|-----------|---------------------------------------|----------|----------|--------|--------|
| ESW II    | Affiliated real estate joint ventures | 76       |          | 151    |        |
| ESNPS     | Affiliated real estate joint ventures | 117      | 109      | 231    | 216    |
| PRISA     | Affiliated real estate joint ventures | 1,258    | 1,294    | 2,521  | 2,595  |
| PRISA II  | Affiliated real estate joint ventures | 1,026    | 1,048    | 2,057  | 2,090  |
| PRISA III | Affiliated real estate joint ventures | 438      | 474      | 881    | 942    |
| VRS       | Affiliated real estate joint ventures | 291      | 283      | 583    | 568    |
| WCOT      | Affiliated real estate joint ventures | 381      | 387      | 765    | 768    |
| SP I      | Affiliated real estate joint ventures | 318      | 316      | 638    | 626    |
| SPB II    | Affiliated real estate joint ventures | 251      | 254      | 506    | 516    |
| Various   | Franchisees, third parties and other  | 1,077    | 869      | 1,869  | 1,812  |
|           |                                       | \$ 5,343 | \$ 5,143 | 10,420 | 10,351 |

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 \$222 and \$266 for the three months ended June 30, 2008 and 2007, respectively, and \$427 and \$455 for the six months ended June 30, 2008 and 2007, respectively, relating to the purchase of software and to license agreements.

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

|                                   | June 30, 2008 |       | December 31, 2007 |       |
|-----------------------------------|---------------|-------|-------------------|-------|
| <u>Receivables:</u>               |               |       |                   |       |
| Development fees                  | \$            | 1,503 | \$                | 1,501 |
| Other receivables from properties |               | 7,735 |                   | 5,885 |
|                                   | \$            | 9,238 | \$                | 7,386 |

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 June 30, 2008 or December 31, 2007.

## 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 \$137,800. Preferred OP units totaling 909,075, with a value of \$121,700, were issued along with the assumption of approximately \$14,200 of third-party debt, of which \$11,400 was paid off at close. The final property was contributed on August 1, 2007 in exchange for consideration totaling \$14,700. 80,905 Preferred OP units with a value of \$9,800 were issued along with \$4,900 of cash.

On June 25, 2007, the Operating Partnership loaned the holders of the Preferred OP units \$100,000. The note receivable bears interest at 4.85%, and is due September 1, 2017. The loan is secured by the borrower's Preferred OP units. The holders of the Preferred OP units can convert up to 114,500 Preferred OP units prior to the maturity date of the loan. If any redemption in excess of 114,500 Preferred OP units occurs prior to the maturity date, the holder of the Preferred OP units is required to repay the loan as of the date of that Preferred OP unit redemption. Preferred OP units are shown on the balance sheet net of the \$100,000 loan under the guidance in EITF No. 85-1, *Classifying Notes Receivable for 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.

Under the Partnership Agreement, Preferred OP units in the amount of \$115,000 bear a fixed priority return of 5% and have a fixed liquidation value of \$115,000. The remaining balance will participate in distributions with and have a liquidation value equal to that of the common OP 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 through earnings. For the year ended December 31, 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 (the Amendment). 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 the 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. The Preferred OP units are included on the consolidated balance sheet as the minority interest represented by Preferred OP units, and no recurring fair value measurements are required subsequent to the date of the

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Amendment.

**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 94.16% majority ownership interest therein as of June 30, 2008. The remaining ownership interests in the Operating Partnership (including Preferred OP units) of 5.84% are held by certain former owners of assets acquired by the Operating Partnership, which include officers and a director 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 CCUs. 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 (10 day average) at the time of the redemption. Alternatively, the Company may, at its option, elect to acquire those OP units in exchange for shares of its common stock on a one-for-one basis, subject to anti-dilution adjustments provided in the Partnership Agreement. The ten day average closing stock price at June 30, 2008 was \$15.52 and there were 4,090,771 OP units outstanding. Assuming that all of the unit holders exercised their right to redeem all of their OP units on June 30, 2008 and the Company elected to pay the non-controlling members cash, the Company would have paid \$63,489 in cash consideration to redeem the OP units.

As of June 30, 2008, the Operating Partnership had 4,090,771 and 89,248 OP units and CCUs outstanding, respectively.

Unlike the OP units, CCUs do not carry any voting rights. Upon the achievement of certain performance thresholds relating to 14 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 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 \$5,100 by \$4,600. If any CCU remains 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 properties.

As of June 30, 2008, there were 110,798 CCUs converted to OP units. Based on the performance of the properties as of June 30, 2008, an additional 18,263 CCUs became eligible for conversion. The board of directors approved the conversion of these CCUs on August 1, 2008 as

per the Company's charter, and the OP units were issued on August 5, 2008.

## 17. STOCKHOLDERS' EQUITY

The Company's charter provides that it can issue up to 300,000,000 shares of common stock, \$0.01 par value per share, 4,100,000 CCSs, \$0.01 par value per share, and 50,000,000 shares of preferred stock, \$0.01 par value per share. As of June 30, 2008, 81,934,549 shares of common stock were issued and outstanding, 1,734,958 CCSs were issued and outstanding and no shares of preferred stock were issued and outstanding. All holders of the Company's common stock are entitled to receive dividends and to one vote on all matters submitted to a vote of stockholders.

On May 19, 2008, the Company closed a public common stock offering of 14,950,000 shares at an offering price of \$16.35 per share, for aggregate gross proceeds of \$244,433. Transaction costs were \$11,715 for net proceeds of \$232,718. A portion of the proceeds was used for the repayment of mortgage debt and outstanding amounts under our Credit Line, and the remaining net proceeds will be used for general corporate purposes, including funding potential future acquisitions.

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 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 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

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stock will be equal to the percentage determined by dividing the net operating income for such period in excess of \$5,100 by \$4,600. If any CCS remains 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 properties.

As of June 30, 2008, there were 2,153,885 CCSs converted to common stock. Based on the performance of the properties as of June 30, 2008, an additional 355,035 CCSs became eligible for conversion. The board of directors approved the conversion of these CCSs on August 1, 2008 as per the Company's charter, and the shares were issued on August 5, 2008.

## 18. STOCK-BASED COMPENSATION

The Company has the following two stock option plans under which shares were available for grant at June 30, 2008: 1) the 2004 Long-Term Incentive Compensation Plan as amended and restated, effective March 25, 2008, and 2) the 2004 Non-Employee Directors' Share Plan (together, the "Plans"). Option grants are issued at the closing price of stock on the date of grant. Each option will be exercisable after the period or periods specified in the award agreement (typically four years), which will generally 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, but under no circumstances may 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 Committee at the time of grant, options shall vest ratably over a four-year period beginning on the date of grant.

Also as defined under the terms of the Plans, restricted stock grants may be awarded. The stock grants are subject to a performance or vesting period over which the restrictions are lifted and the stock certificates are given to the grantee. During the performance or vesting period, the grantee is not permitted to sell, transfer, pledge, encumber or assign shares of restricted stock granted under the Plans, however the grantee has the ability to vote the shares and receive dividends paid on the shares. The forfeiture and transfer restrictions on the shares lapse over a two to four-year period beginning on the date of grant.

### Option Grants to Employees

As of June 30, 2008, 4,688,440 shares were available for issuance under the Plans. A summary of stock option activity is as follows:

|                                          | Number of<br>Shares | Weighted<br>Average Exercise<br>Price | Weighted Average<br>Remaining<br>Contractual Life | Aggregate Intrinsic<br>Value as of June<br>30, 2008 |
|------------------------------------------|---------------------|---------------------------------------|---------------------------------------------------|-----------------------------------------------------|
| Options Outstanding at December 31, 2006 | 2,564,563           | \$ 13.92                              |                                                   |                                                     |
| Granted                                  | 418,000             | 18.51                                 |                                                   |                                                     |

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|                                  |           |    |       |      |          |
|----------------------------------|-----------|----|-------|------|----------|
| Exercised                        | (126,801) |    | 13.68 |      |          |
| Forfeited                        | (204,044) |    | 14.71 |      |          |
| Outstanding at December 31, 2007 | 2,651,718 | \$ | 14.54 |      |          |
| Granted                          | 380,000   |    | 15.57 |      |          |
| Exercised                        | (67,750)  |    | 12.98 |      |          |
| Forfeited                        | (29,625)  |    | 13.60 |      |          |
| Outstanding at June 30, 2008     | 2,934,343 | \$ | 14.72 | 7.29 | \$ 3,607 |
| Vested and Expected to Vest      | 2,626,353 | \$ | 14.54 | 7.12 | \$ 3,499 |
| Ending Exercisable               | 1,397,186 | \$ | 13.96 | 6.64 | \$ 2,380 |

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 second quarter of 2008 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 June 30, 2008. The amount of aggregate intrinsic value will change based on the fair market value of the Company's stock.

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The fair value of each option grant is estimated using the Black-Scholes option-pricing model with the following assumptions:

|                               | Six Months Ended June 30, |      |
|-------------------------------|---------------------------|------|
|                               | 2008                      | 2007 |
| Expected volatility           | 26%                       | 23%  |
| Dividend yield                | 6.4%                      | 5.8% |
| Risk-free interest rate       | 2.7%                      | 4.9% |
| 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, dividend yield and average expected term. The forfeiture rate, which is estimated at a weighted-average of 19.72% of unvested options outstanding as of June 30, 2008, is adjusted periodically based on the extent to which actual forfeitures differ, or are expected to differ, from the previous estimates.

The Company recorded compensation expense relating to outstanding options of \$232 and \$196 for the three months ended June 30, 2008 and 2007, respectively, and \$495 and \$419 for the six months ended June 30, 2008 and 2007, respectively. The Company received cash from the exercise of options of \$274 and \$305 for the three months ended June 30, 2008 and 2007, respectively, and \$940 and \$1,033 for the six months ended June 30, 2008 and 2007, respectively. At June 30, 2008, there was \$1,053 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 1.90 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 expense at June 30, 2008, 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 and Directors**

The Company granted 182,139 and 59,729 shares of common stock to certain employees, without monetary consideration under the Plans during the three months ended June 30, 2008 and 2007, respectively, and 353,939 and 90,529 shares for the six months ended June 30, 2008 and 2007, respectively. The Company recorded compensation expense related to outstanding shares of common stock granted to employees of \$951 and \$242 during the three months ended June 30, 2008 and 2007, respectively, and \$1,489 and \$456 during the six months ended June 30, 2008 and 2007, 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-Average Grant-Date Fair Value |
|---------------------------------|---------|----------------------------------------|
| Unreleased at December 31, 2006 | 156,300 | \$ 15.94                               |
| Granted                         | 120,729 | 18.17                                  |

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|                                 |            |       |
|---------------------------------|------------|-------|
| Released                        | (61,975)   | 15.90 |
| Cancelled                       | (3,082)    | 18.39 |
| Unreleased at December 31, 2007 | 211,972 \$ | 17.23 |
| Granted                         | 353,939    | 15.73 |
| Released                        | (83,356)   | 16.77 |
| Cancelled                       | (2,571)    | 17.74 |
| Unreleased at June 30, 2008     | 479,984 \$ | 16.24 |

## 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:

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|                                                                                                                                                  | June 30, 2008 |                                  | December 31, 2007 |               |                                |               |
|--------------------------------------------------------------------------------------------------------------------------------------------------|---------------|----------------------------------|-------------------|---------------|--------------------------------|---------------|
| <b>Balance Sheet</b>                                                                                                                             |               |                                  |                   |               |                                |               |
| Investment in real estate ventures                                                                                                               |               |                                  |                   |               |                                |               |
| Rental operations                                                                                                                                | \$            | 95,819                           | \$                | 95,169        |                                |               |
|                                                                                                                                                  |               |                                  |                   |               |                                |               |
| Total assets                                                                                                                                     |               |                                  |                   |               |                                |               |
| Property management, acquisition and development                                                                                                 | \$            | 564,852                          | \$                | 385,394       |                                |               |
| Rental operations                                                                                                                                |               | 1,684,425                        |                   | 1,668,681     |                                |               |
|                                                                                                                                                  | \$            | 2,249,277                        | \$                | 2,054,075     |                                |               |
|                                                                                                                                                  |               |                                  |                   |               |                                |               |
|                                                                                                                                                  |               | Three months ended June 30, 2008 |                   | June 30, 2007 | Six months ended June 30, 2008 | June 30, 2007 |
| <b>Statement of Operations</b>                                                                                                                   |               |                                  |                   |               |                                |               |
| Total revenues                                                                                                                                   |               |                                  |                   |               |                                |               |
| Property management, acquisition and development                                                                                                 | \$            | 9,451                            | \$                | 8,158         | \$                             | 18,134        |
| Rental operations                                                                                                                                |               | 57,885                           |                   | 48,392        |                                | 114,909       |
|                                                                                                                                                  | \$            | 67,336                           | \$                | 56,550        | \$                             | 133,043       |
|                                                                                                                                                  |               |                                  |                   |               |                                |               |
| Operating expenses, including depreciation and amortization                                                                                      |               |                                  |                   |               |                                |               |
| Property management, acquisition and development                                                                                                 | \$            | 13,242                           | \$                | 10,684        | \$                             | 25,099        |
| Rental operations                                                                                                                                |               | 32,186                           |                   | 26,135        |                                | 64,056        |
|                                                                                                                                                  | \$            | 45,428                           | \$                | 36,819        | \$                             | 89,155        |
|                                                                                                                                                  |               |                                  |                   |               |                                |               |
| Income (loss) before interest, loss on sale of investments available for sale, minority interests and equity in earnings of real estate ventures |               |                                  |                   |               |                                |               |
| Property management, acquisition and development                                                                                                 | \$            | (3,791)                          | \$                | (2,526)       | \$                             | (6,965)       |
| Rental operations                                                                                                                                |               | 25,699                           |                   | 22,257        |                                | 50,853        |
|                                                                                                                                                  | \$            | 21,908                           | \$                | 19,731        | \$                             | 43,888        |
|                                                                                                                                                  |               |                                  |                   |               |                                |               |
| Interest expense                                                                                                                                 |               |                                  |                   |               |                                |               |
| Property management, acquisition and development                                                                                                 | \$            | (328)                            | \$                | (401)         | \$                             | (676)         |
| Rental operations                                                                                                                                |               | (15,634)                         |                   | (15,036)      |                                | (31,640)      |
|                                                                                                                                                  | \$            | (15,962)                         | \$                | (15,437)      | \$                             | (32,316)      |
|                                                                                                                                                  |               |                                  |                   |               |                                |               |
| Interest income                                                                                                                                  |               |                                  |                   |               |                                |               |
| Property management, acquisition and development                                                                                                 | \$            | 870                              | \$                | 3,668         | \$                             | 1,295         |
|                                                                                                                                                  |               |                                  |                   |               |                                |               |
| Interest income on note receivable from Preferred Unit holder                                                                                    |               |                                  |                   |               |                                |               |
| Property management, acquisition and development                                                                                                 | \$            | 1,212                            | \$                |               | \$                             | 2,425         |
|                                                                                                                                                  |               |                                  |                   |               |                                |               |
| Equity in earnings of real estate ventures                                                                                                       |               |                                  |                   |               |                                |               |
| Rental operations                                                                                                                                | \$            | 1,373                            | \$                | 1,192         | \$                             | 2,595         |
|                                                                                                                                                  |               |                                  |                   |               |                                |               |
| Loss on sale of investments available for sale                                                                                                   |               |                                  |                   |               |                                |               |
| Property management, acquisition and development                                                                                                 | \$            |                                  | \$                |               | \$                             | (1,415)       |
|                                                                                                                                                  |               |                                  |                   |               |                                |               |
| Minority interests - Operating Partnership and other                                                                                             |               |                                  |                   |               |                                |               |
| Property management, acquisition and development                                                                                                 | \$            | (500)                            | \$                | (459)         | \$                             | (871)         |
|                                                                                                                                                  |               |                                  |                   |               |                                |               |
| Net income (loss)                                                                                                                                |               |                                  |                   |               |                                |               |
| Property management, acquisition and development                                                                                                 | \$            | (2,538)                          | \$                | 282           | \$                             | (6,207)       |
|                                                                                                                                                  |               |                                  |                   |               |                                | (2,013)       |

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|                   |          |          |           |           |
|-------------------|----------|----------|-----------|-----------|
| Rental operations | 11,438   | 8,413    | 21,808    | 17,178    |
|                   | \$ 8,901 | \$ 8,695 | \$ 15,601 | \$ 15,165 |

**Depreciation and amortization expense**

|                                                  |           |          |           |           |
|--------------------------------------------------|-----------|----------|-----------|-----------|
| Property management, acquisition and development | \$ 374    | \$ 340   | \$ 726    | \$ 602    |
| Rental operations                                | 11,323    | 8,783    | 22,552    | 17,317    |
|                                                  | \$ 11,697 | \$ 9,123 | \$ 23,278 | \$ 17,919 |

**Statement of Cash Flows**

|                                                    |  |             |             |  |
|----------------------------------------------------|--|-------------|-------------|--|
| Acquisition of real estate assets                  |  |             |             |  |
| Property management, acquisition and development   |  | \$ (37,017) | \$ (98,148) |  |
| Development and construction of real estate assets |  |             |             |  |
| Property management, acquisition and development   |  | \$ (29,532) | \$ (19,381) |  |

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**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 between 10% and 50% equity interests. These guarantees were entered into in November 2004, July 2005 and August 2007, respectively. At June 30, 2008, the total amount of guaranteed mortgage debt relating to these joint ventures was \$17,893. These mortgage loans mature December 1, 2008, July 29, 2009 and August 3, 2010, 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 June 30, 2008 was \$23,129. The Company recorded no liability in relation to these guarantees as of June 30, 2008, as the fair values of the guarantees were 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 guarantees is remote.

The Company has been involved in routine litigation arising in the ordinary course of business. As of June 30, 2008, 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 on January 1, 2007. The Company recognized no material adjustment in the liability for unrecognized income tax benefits as a result of the implementation of FIN 48. At June 30, 2008, there were no material uncertain tax positions.

Interest and penalties related to uncertain tax positions will be recognized in income tax expense, when incurred. As of June 30, 2008, the Company had no interest or penalties related to uncertain tax positions.

The tax years 2005-2007 remain open to examination by the major taxing jurisdictions to which the Company is subject.

**22. SUBSEQUENT EVENTS**

On July 1, 2008, the Company purchased an additional 40.0% interest in VRS Self Storage LLC from Prudential Real Estate Investors for cash of \$43,999, resulting in an increase in the Company's total interest in the joint venture from 5.0% to 45.0%.

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**Extra Space Storage Inc.**

**Management's Discussion and Analysis**

**Amounts in thousands, except property and 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, 2007. 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 property and 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 consolidated financial statements contained elsewhere in this report and the audited financial statements contained in our Form 10-K for the year ended December 31, 2007 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 revenues and expenses during the period presented. If there are material differences between these estimates, judgments and assumptions and actual facts, our financial statements may be affected.

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

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**OVERVIEW**

We are a fully integrated, self-administered and self-managed real estate investment trust, or REIT, 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, franchisee and managed properties.

We operate in competitive markets where consumers have multiple self-storage properties from which to choose. Competition has impacted, and will continue to impact our property results. We experience minor seasonal fluctuations in occupancy levels, with occupancy levels higher in the summer months due to increased moving 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 new initiatives and opportunities in order to enable us to maximize stockholder value. Our strategies to maximize stockholder value include the following:

- *Maximize the performance of properties through strategic, efficient and proactive management.* We plan to pursue revenue

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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 allows 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. We have established a 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 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 2008 through 2009 includes 23 projects. The majority of the projects will be developed on a wholly-owned basis by the Company.
- *Expand our management business.* We see our management business as a future acquisition pipeline. We 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. Nineteen of the 39 acquisitions completed by us in 2007 came from this channel.

**PROPERTIES**

As of June 30, 2008, we owned or had ownership interests in 610 operating self-storage properties located in 33 states and Washington, D.C. Of these properties, 263 are wholly-owned and consolidated, two are held in joint ventures and consolidated and 345 are held in joint ventures accounted for using the equity method. In addition, we managed 63 properties for franchisees or third parties bringing the total numbers of properties which we own and/or manage to 673. We receive a management fee equal to approximately 6% of gross revenues to manage the joint venture, third party and franchise sites. As of June 30, 2008, we owned and/or managed approximately 49 million square feet of space with more 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. Our acquisitions have given us increased scale in many core markets as well as a foothold in many markets where we had no previous presence.

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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 June 30, 2008, 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 June 30, 2008 and 2007. The information as of June 30, 2007 is on a pro forma basis as though all the properties owned and/or managed at June 30, 2008 were under our control as of June 30, 2007.

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**Stabilized Property Data Based on Location**

| Location                       | Number of Properties | Company Number of Units as of June 30, 2008(1) | Pro forma Number of Units as of June 30, 2007 | Company Net Rentable Square Feet as of June 30, 2008(2) | Pro forma Net Rentable Square Feet as of June 30, 2007 | Company Square Foot Occupancy % June 30, 2008 | Pro forma Square Foot Occupancy % June 30, 2007 |
|--------------------------------|----------------------|------------------------------------------------|-----------------------------------------------|---------------------------------------------------------|--------------------------------------------------------|-----------------------------------------------|-------------------------------------------------|
| <b>Wholly-owned properties</b> |                      |                                                |                                               |                                                         |                                                        |                                               |                                                 |
| Alabama                        | 1                    | 582                                            | 593                                           | 76,025                                                  | 76,205                                                 | 82.3%                                         | 75.2%                                           |
| Arizona                        | 4                    | 2,263                                          | 2,260                                         | 279,943                                                 | 280,180                                                | 91.0%                                         | 93.9%                                           |
| California                     | 44                   | 35,989                                         | 36,286                                        | 3,468,721                                               | 3,468,185                                              | 86.4%                                         | 82.5%                                           |
| Colorado                       | 7                    | 3,287                                          | 3,329                                         | 419,844                                                 | 418,444                                                | 89.5%                                         | 88.9%                                           |
| Connecticut                    | 2                    | 1,352                                          | 1,357                                         | 123,265                                                 | 123,265                                                | 81.3%                                         | 80.1%                                           |
| Florida                        | 29                   | 19,349                                         | 19,395                                        | 2,028,026                                               | 2,027,850                                              | 83.8%                                         | 86.4%                                           |
| Georgia                        | 12                   | 6,436                                          | 6,448                                         | 835,326                                                 | 835,528                                                | 90.4%                                         | 88.0%                                           |
| Hawaii                         | 2                    | 2,869                                          | 2,890                                         | 149,917                                                 | 153,351                                                | 83.8%                                         | 81.2%                                           |
| Illinois                       | 5                    | 3,267                                          | 3,265                                         | 339,014                                                 | 342,254                                                | 83.2%                                         | 85.2%                                           |
| Indiana                        | 1                    | 590                                            | 589                                           | 62,250                                                  | 62,250                                                 | 89.4%                                         | 87.8%                                           |
| Kansas                         | 1                    | 504                                            | 505                                           | 49,690                                                  | 49,940                                                 | 93.3%                                         | 90.4%                                           |
| Kentucky                       | 3                    | 1,585                                          | 1,586                                         | 194,470                                                 | 194,351                                                | 90.3%                                         | 91.5%                                           |
| Louisiana                      | 2                    | 1,409                                          | 1,407                                         | 148,315                                                 | 147,490                                                | 90.3%                                         | 93.2%                                           |
| Maryland                       | 9                    | 7,446                                          | 7,450                                         | 796,669                                                 | 795,086                                                | 86.2%                                         | 85.6%                                           |
| Massachusetts                  | 26                   | 14,872                                         | 14,883                                        | 1,577,295                                               | 1,581,016                                              | 85.9%                                         | 84.9%                                           |
| Michigan                       | 2                    | 1,042                                          | 1,041                                         | 135,906                                                 | 134,402                                                | 93.5%                                         | 90.6%                                           |
| Missouri                       | 6                    | 3,149                                          | 3,169                                         | 374,332                                                 | 375,377                                                | 88.9%                                         | 86.3%                                           |
| Nevada                         | 2                    | 1,255                                          | 1,256                                         | 132,315                                                 | 132,465                                                | 88.4%                                         | 84.3%                                           |
| New Hampshire                  | 2                    | 1,006                                          | 1,006                                         | 125,909                                                 | 125,609                                                | 87.4%                                         | 81.9%                                           |
| New Jersey                     | 23                   | 18,858                                         | 18,847                                        | 1,835,271                                               | 1,833,488                                              | 87.1%                                         | 86.0%                                           |
| New Mexico                     | 1                    | 535                                            | 511                                           | 68,090                                                  | 63,850                                                 | 85.5%                                         | 96.0%                                           |
| New York                       | 8                    | 7,170                                          | 7,247                                         | 487,282                                                 | 487,584                                                | 82.3%                                         | 82.5%                                           |
| Ohio                           | 4                    | 2,025                                          | 2,040                                         | 273,492                                                 | 275,401                                                | 89.9%                                         | 87.8%                                           |
| Oregon                         | 1                    | 765                                            | 764                                           | 103,450                                                 | 103,450                                                | 89.8%                                         | 95.7%                                           |
| Pennsylvania                   | 8                    | 6,147                                          | 6,133                                         | 637,129                                                 | 640,568                                                | 87.9%                                         | 86.9%                                           |
| Rhode Island                   | 1                    | 728                                            | 731                                           | 75,361                                                  | 75,241                                                 | 89.4%                                         | 85.7%                                           |
| South Carolina                 | 3                    | 1,554                                          | 1,554                                         | 178,719                                                 | 178,689                                                | 92.3%                                         | 92.8%                                           |
| Tennessee                      | 6                    | 3,508                                          | 3,535                                         | 475,267                                                 | 477,547                                                | 88.4%                                         | 87.3%                                           |
| Texas                          | 19                   | 11,819                                         | 11,881                                        | 1,338,065                                               | 1,335,850                                              | 89.6%                                         | 91.1%                                           |
| Utah                           | 3                    | 1,537                                          | 1,535                                         | 210,976                                                 | 210,490                                                | 93.6%                                         | 96.6%                                           |
| Virginia                       | 4                    | 2,891                                          | 2,890                                         | 272,699                                                 | 272,825                                                | 89.9%                                         | 88.0%                                           |
| Washington                     | 4                    | 2,541                                          | 2,532                                         | 305,815                                                 | 306,115                                                | 89.7%                                         | 98.4%                                           |
| <b>Total</b>                   |                      |                                                |                                               |                                                         |                                                        |                                               |                                                 |
| <b>Wholly-Owned Stabilized</b> | <b>245</b>           | <b>168,330</b>                                 | <b>168,915</b>                                | <b>17,578,848</b>                                       | <b>17,584,346</b>                                      | <b>87.1%</b>                                  | <b>86.5%</b>                                    |

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| Location                        | Number of Properties | Company Number of Units as of June 30, 2008(1) | Pro forma Number of Units as of June 30, 2007 | Company Net Rentable Square Feet as of June 30, 2008(2) | Pro forma Net Rentable Square Feet as of June 30 2007 | Company Square Foot Occupancy % June 30, 2008 | Pro forma Square Foot Occupancy % June 30, 2007 |
|---------------------------------|----------------------|------------------------------------------------|-----------------------------------------------|---------------------------------------------------------|-------------------------------------------------------|-----------------------------------------------|-------------------------------------------------|
| <b>Joint-venture properties</b> |                      |                                                |                                               |                                                         |                                                       |                                               |                                                 |
| Alabama                         | 3                    | 1,708                                          | 1,707                                         | 205,553                                                 | 205,813                                               | 90.0%                                         | 93.7%                                           |
| Arizona                         | 11                   | 6,887                                          | 6,901                                         | 751,271                                                 | 751,141                                               | 87.4%                                         | 92.0%                                           |
| California                      | 76                   | 54,510                                         | 54,573                                        | 5,590,645                                               | 5,590,929                                             | 90.2%                                         | 89.8%                                           |
| Colorado                        | 2                    | 1,334                                          | 1,335                                         | 158,413                                                 | 158,213                                               | 87.1%                                         | 89.5%                                           |
| Connecticut                     | 8                    | 5,989                                          | 5,979                                         | 692,477                                                 | 690,389                                               | 80.6%                                         | 78.3%                                           |
| Delaware                        | 1                    | 589                                            | 589                                           | 71,655                                                  | 71,655                                                | 90.2%                                         | 94.3%                                           |
| Florida                         | 23                   | 19,258                                         | 19,294                                        | 1,939,953                                               | 1,940,595                                             | 84.3%                                         | 85.4%                                           |
| Georgia                         | 3                    | 1,889                                          | 1,891                                         | 246,926                                                 | 246,406                                               | 83.4%                                         | 79.4%                                           |
| Illinois                        | 6                    | 3,995                                          | 4,033                                         | 429,967                                                 | 433,562                                               | 88.5%                                         | 82.8%                                           |
| Indiana                         | 8                    | 3,151                                          | 3,151                                         | 405,269                                                 | 406,503                                               | 87.2%                                         | 90.6%                                           |
| Kansas                          | 3                    | 1,222                                          | 1,217                                         | 163,800                                                 | 164,225                                               | 86.3%                                         | 87.9%                                           |
| Kentucky                        | 4                    | 2,284                                          | 2,282                                         | 268,358                                                 | 268,509                                               | 89.0%                                         | 88.9%                                           |
| Maryland                        | 13                   | 10,218                                         | 10,223                                        | 1,013,143                                               | 1,013,328                                             | 87.8%                                         | 88.4%                                           |
| Massachusetts                   | 17                   | 9,257                                          | 9,286                                         | 1,047,132                                               | 1,047,379                                             | 83.7%                                         | 84.2%                                           |
| Michigan                        | 10                   | 5,965                                          | 5,968                                         | 786,623                                                 | 785,447                                               | 90.4%                                         | 87.8%                                           |
| Missouri                        | 2                    | 951                                            | 951                                           | 117,715                                                 | 118,195                                               | 94.1%                                         | 86.2%                                           |
| Nevada                          | 7                    | 4,621                                          | 4,630                                         | 619,079                                                 | 620,549                                               | 84.5%                                         | 88.5%                                           |
| New Hampshire                   | 3                    | 1,320                                          | 1,326                                         | 138,034                                                 | 138,554                                               | 88.6%                                         | 87.3%                                           |
| New Jersey                      | 21                   | 15,691                                         | 15,708                                        | 1,649,733                                               | 1,657,638                                             | 84.7%                                         | 81.9%                                           |
| New Mexico                      | 9                    | 4,691                                          | 4,689                                         | 539,008                                                 | 540,018                                               | 85.5%                                         | 84.7%                                           |
| New York                        | 21                   | 22,150                                         | 22,071                                        | 1,718,119                                               | 1,713,932                                             | 89.2%                                         | 86.3%                                           |
| Ohio                            | 11                   | 5,016                                          | 5,027                                         | 747,777                                                 | 751,107                                               | 84.3%                                         | 87.4%                                           |
| Oregon                          | 2                    | 1,293                                          | 1,291                                         | 136,830                                                 | 137,140                                               | 94.0%                                         | 91.2%                                           |
| Pennsylvania                    | 10                   | 7,214                                          | 7,228                                         | 762,520                                                 | 764,114                                               | 88.4%                                         | 88.2%                                           |
| Rhode Island                    | 1                    | 607                                            | 611                                           | 73,880                                                  | 73,905                                                | 79.1%                                         | 75.8%                                           |
| Tennessee                       | 22                   | 11,795                                         | 11,828                                        | 1,548,493                                               | 1,547,503                                             | 89.4%                                         | 88.8%                                           |
| Texas                           | 18                   | 11,789                                         | 11,837                                        | 1,559,796                                               | 1,519,316                                             | 82.1%                                         | 81.4%                                           |
| Utah                            | 1                    | 519                                            | 519                                           | 59,400                                                  | 59,500                                                | 94.6%                                         | 97.2%                                           |
| Virginia                        | 16                   | 11,279                                         | 11,271                                        | 1,191,648                                               | 1,191,049                                             | 88.7%                                         | 87.3%                                           |
| Washington                      | 1                    | 551                                            | 551                                           | 62,730                                                  | 62,730                                                | 91.2%                                         | 94.9%                                           |
| Washington, DC                  | 1                    | 1,536                                          | 1,536                                         | 102,003                                                 | 102,003                                               | 98.2%                                         | 94.9%                                           |
| <b>Total Stabilized</b>         |                      |                                                |                                               |                                                         |                                                       |                                               |                                                 |
| <b>Joint-Ventures</b>           | <b>334</b>           | <b>229,279</b>                                 | <b>229,503</b>                                | <b>24,797,950</b>                                       | <b>24,771,347</b>                                     | <b>87.3%</b>                                  | <b>86.9%</b>                                    |

| Location                  | Number of Properties | Company Number of Units as of June 30, 2008(1) | Pro forma Number of Units as of June 30, 2007 | Company Net Rentable Square Feet as of June 30, 2008(2) | Pro forma Net Rentable Square Feet as of June 30 2007 | Company Square Foot Occupancy % June 30, 2008 | Pro forma Square Foot Occupancy % June 30, 2007 |
|---------------------------|----------------------|------------------------------------------------|-----------------------------------------------|---------------------------------------------------------|-------------------------------------------------------|-----------------------------------------------|-------------------------------------------------|
| <b>Managed properties</b> |                      |                                                |                                               |                                                         |                                                       |                                               |                                                 |
| Alabama                   | 2                    | 826                                            | 826                                           | 95,207                                                  | 95,207                                                | 92.1%                                         | 92.1%                                           |
| California                | 6                    | 3,907                                          | 3,937                                         | 488,260                                                 | 488,935                                               | 78.3%                                         | 77.6%                                           |
| Colorado                  | 1                    | 513                                            | 513                                           | 56,240                                                  | 56,240                                                | 94.7%                                         | 91.3%                                           |
| Florida                   | 1                    | 650                                            | 653                                           | 51,966                                                  | 52,096                                                | 90.0%                                         | 92.3%                                           |
| Georgia                   | 5                    | 2,755                                          | 2,755                                         | 416,408                                                 | 416,408                                               | 78.4%                                         | 78.4%                                           |
| Illinois                  | 4                    | 2,331                                          | 2,331                                         | 248,780                                                 | 248,780                                               | 71.2%                                         | 71.2%                                           |
| Maryland                  | 7                    | 4,646                                          | 4,636                                         | 475,597                                                 | 475,932                                               | 88.4%                                         | 86.6%                                           |
| Nevada                    | 2                    | 1,576                                          | 1,576                                         | 171,555                                                 | 171,555                                               | 87.4%                                         | 88.0%                                           |
| New Jersey                | 4                    | 3,905                                          | 3,798                                         | 362,437                                                 | 340,421                                               | 78.3%                                         | 77.9%                                           |
| New Mexico                | 2                    | 1,103                                          | 1,096                                         | 131,867                                                 | 131,472                                               | 90.6%                                         | 93.3%                                           |
| New York                  | 1                    | 706                                            | 706                                           | 78,075                                                  | 78,075                                                | 84.2%                                         | 84.2%                                           |
| Pennsylvania              | 3                    | 1,386                                          | 1,388                                         | 176,211                                                 | 176,211                                               | 74.0%                                         | 71.7%                                           |
| Tennessee                 | 2                    | 886                                            | 888                                           | 130,750                                                 | 131,130                                               | 92.4%                                         | 95.0%                                           |
| Texas                     | 4                    | 2,279                                          | 2,314                                         | 260,715                                                 | 260,915                                               | 91.7%                                         | 88.6%                                           |
| Utah                      | 1                    | 371                                            | 371                                           | 46,955                                                  | 46,955                                                | 98.8%                                         | 99.4%                                           |

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|                                            |            |                |                |                   |                   |              |              |
|--------------------------------------------|------------|----------------|----------------|-------------------|-------------------|--------------|--------------|
| Virginia                                   | 5          | 3,475          | 3,469          | 344,837           | 344,602           | 86.0%        | 84.4%        |
| Washington, DC                             | 2          | 1,255          | 1,255          | 111,759           | 111,759           | 88.1%        | 82.5%        |
| <b>Total Stabilized Managed Properties</b> | <b>52</b>  | <b>32,570</b>  | <b>32,512</b>  | <b>3,647,619</b>  | <b>3,626,693</b>  | <b>83.5%</b> | <b>82.7%</b> |
| <b>Total Stabilized Properties</b>         | <b>631</b> | <b>430,179</b> | <b>430,930</b> | <b>46,024,417</b> | <b>45,982,386</b> | <b>86.9%</b> | <b>86.4%</b> |

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(1) Represents unit count as of June 30, 2008, which may differ from June 30, 2007 unit count due to unit conversions or expansions.

(2) Represents net rentable square feet as of June 30, 2008, which may differ from June 30, 2007 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 June 30, 2008 and 2007. The information as of June 30, 2007 is on a pro forma basis as though all the properties owned and/or

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managed at June 30, 2008 were under our control as of June 30, 2007.

### Lease-up Property Data Based on Location

| Location                           | Number of Properties | Company Number of Units as of June 30, 2008(1) | Pro forma Number of Units as of June 30, 2007 | Company Net Rentable Square Feet as of June 30, 2008(2) | Pro forma Net Rentable Square Feet as of June 30, 2007 | Company Square Foot Occupancy % June 30, 2008 | Pro forma Square Foot Occupancy % June 30, 2007 |
|------------------------------------|----------------------|------------------------------------------------|-----------------------------------------------|---------------------------------------------------------|--------------------------------------------------------|-----------------------------------------------|-------------------------------------------------|
| <b>Wholly-owned properties</b>     |                      |                                                |                                               |                                                         |                                                        |                                               |                                                 |
| Arizona                            | 1                    | 585                                            | 587                                           | 67,375                                                  | 67,375                                                 | 81.0%                                         | 77.3%                                           |
| California                         | 5                    | 3,442                                          | 2,744                                         | 387,915                                                 | 331,751                                                | 59.8%                                         | 50.4%                                           |
| Connecticut                        | 1                    | 684                                            | 683                                           | 54,850                                                  | 54,840                                                 | 96.4%                                         | 94.9%                                           |
| Florida                            | 2                    | 1,257                                          | 1,257                                         | 157,788                                                 | 157,005                                                | 81.2%                                         | 71.8%                                           |
| Illinois                           | 2                    | 1,383                                          |                                               | 156,980                                                 |                                                        | 22.0%                                         | 0.0%                                            |
| Maryland                           | 1                    | 635                                            |                                               | 79,958                                                  |                                                        | 31.9%                                         | 0.0%                                            |
| Massachusetts                      | 3                    | 2,450                                          | 2,449                                         | 210,159                                                 | 211,297                                                | 64.8%                                         | 50.4%                                           |
| Pennsylvania                       | 1                    | 422                                            | 424                                           | 46,930                                                  | 47,060                                                 | 80.7%                                         | 79.6%                                           |
| South Carolina                     | 1                    | 513                                            | 513                                           | 67,045                                                  | 67,045                                                 | 93.3%                                         | 90.2%                                           |
| Texas                              | 1                    | 606                                            | 617                                           | 64,650                                                  | 64,650                                                 | 86.5%                                         | 62.5%                                           |
| <b>Total Wholly-Owned Lease-up</b> | <b>18</b>            | <b>11,977</b>                                  | <b>9,274</b>                                  | <b>1,293,650</b>                                        | <b>1,001,023</b>                                       | <b>63.4%</b>                                  | <b>62.8%</b>                                    |

| Location                             | Number of Properties | Company Number of Units as of June 30, 2008(1) | Pro forma Number of Units as of June 30, 2007 | Company Net Rentable Square Feet as of June 30, 2008(2) | Pro forma Net Rentable Square Feet as of June 30, 2007 | Company Square Foot Occupancy % June 30, 2008 | Pro forma Square Foot Occupancy % June 30, 2007 |
|--------------------------------------|----------------------|------------------------------------------------|-----------------------------------------------|---------------------------------------------------------|--------------------------------------------------------|-----------------------------------------------|-------------------------------------------------|
| <b>Joint-venture properties</b>      |                      |                                                |                                               |                                                         |                                                        |                                               |                                                 |
| California                           | 5                    | 3,535                                          | 2,958                                         | 380,651                                                 | 298,602                                                | 59.0%                                         | 48.0%                                           |
| Florida                              | 1                    | 827                                            | 940                                           | 113,401                                                 | 115,425                                                | 48.5%                                         | 15.3%                                           |
| Illinois                             | 3                    | 2,492                                          | 2,516                                         | 264,597                                                 | 264,482                                                | 75.6%                                         | 60.7%                                           |
| Maryland                             | 1                    | 859                                            | 948                                           | 71,249                                                  | 73,666                                                 | 75.5%                                         | 51.1%                                           |
| New Jersey                           | 1                    | 635                                            | 635                                           | 57,360                                                  | 57,335                                                 | 27.1%                                         | 18.5%                                           |
| New York                             | 1                    | 1,574                                          | 1,578                                         | 115,840                                                 | 116,235                                                | 81.9%                                         | 78.9%                                           |
| Rhode Island                         | 1                    | 498                                            | 501                                           | 55,645                                                  | 55,670                                                 | 52.9%                                         | 38.9%                                           |
| <b>Total Lease-up Joint-Ventures</b> | <b>13</b>            | <b>10,420</b>                                  | <b>10,076</b>                                 | <b>1,058,743</b>                                        | <b>981,415</b>                                         | <b>63.6%</b>                                  | <b>49.2%</b>                                    |

| Location                  | Number of Properties | Company Number of Units as of June 30, 2008(1) | Pro forma Number of Units as of June 30, 2007 | Company Net Rentable Square Feet as of June 30, 2008(2) | Pro forma Net Rentable Square Feet as of June 30, 2007 | Company Square Foot Occupancy % June 30, 2008 | Pro forma Square Foot Occupancy % June 30, 2007 |
|---------------------------|----------------------|------------------------------------------------|-----------------------------------------------|---------------------------------------------------------|--------------------------------------------------------|-----------------------------------------------|-------------------------------------------------|
| <b>Managed properties</b> |                      |                                                |                                               |                                                         |                                                        |                                               |                                                 |
| California                | 1                    | 1,048                                          |                                               | 98,558                                                  |                                                        | 1.5%                                          | 0.0%                                            |
| Florida                   | 1                    | 926                                            |                                               | 78,130                                                  |                                                        | 22.0%                                         | 0.0%                                            |
| Virginia                  | 1                    | 480                                            |                                               | 63,899                                                  |                                                        | 12.0%                                         | 0.0%                                            |
| Tennessee                 | 1                    | 510                                            | 510                                           | 68,960                                                  | 68,960                                                 | 54.9%                                         | 54.9%                                           |
| Colorado                  | 1                    | 536                                            |                                               | 60,940                                                  |                                                        | 9.8%                                          | 0.0%                                            |
| Indiana                   | 1                    | 545                                            | 587                                           | 68,690                                                  | 68,890                                                 | 91.4%                                         | 72.9%                                           |

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|                   |           |               |               |                  |                  |              |              |
|-------------------|-----------|---------------|---------------|------------------|------------------|--------------|--------------|
| Massachusetts     | 3         | 2,794         | 2,148         | 260,529          | 190,169          | 53.6%        | 63.3%        |
| New Jersey        | 1         | 860           | 863           | 77,770           | 78,190           | 39.3%        | 20.2%        |
| Pennsylvania      | 1         | 1,129         |               | 104,850          |                  | 18.3%        | 0.0%         |
| <b>Total</b>      |           |               |               |                  |                  |              |              |
| <b>Lease-up</b>   |           |               |               |                  |                  |              |              |
| <b>Managed</b>    | <b>11</b> | <b>8,828</b>  | <b>4,108</b>  | <b>882,326</b>   | <b>406,209</b>   | <b>36.5%</b> | <b>55.2%</b> |
| <b>Total</b>      |           |               |               |                  |                  |              |              |
| <b>Lease-up</b>   |           |               |               |                  |                  |              |              |
| <b>Properties</b> | <b>42</b> | <b>31,225</b> | <b>23,458</b> | <b>3,234,719</b> | <b>2,388,647</b> | <b>56.1%</b> | <b>55.9%</b> |

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(1) Represents unit count as of June 30, 2008, which may differ from June 30, 2007 unit count due to unit conversions or expansions.

(2) Represents net rentable square feet as of June 30, 2008, which may differ from June 30, 2007 net rentable square feet due to unit conversions or expansions.

### RESULTS OF OPERATIONS

#### Comparison of the three and six months ended June 30, 2008 and 2007

##### Overview

Results for the three and six months ended June 30, 2008 include the operations of 610 properties (265 of which were consolidated and 345 of which were in joint ventures accounted for using the equity method) compared to the results for the three and six months ended June 30, 2007, which included the operations of 585 properties (243 of which were consolidated and 342 of which were in joint

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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>June 30, |           |           |          | Six Months Ended<br>June 30, |            |           |          |
|-------------------------------|--------------------------------|-----------|-----------|----------|------------------------------|------------|-----------|----------|
|                               | 2008                           | 2007      | \$ Change | % Change | 2008                         | 2007       | \$ Change | % Change |
| <b>Revenues:</b>              |                                |           |           |          |                              |            |           |          |
| Property rental               | \$ 57,885                      | \$ 48,392 | \$ 9,493  | 19.6%    | \$ 114,909                   | \$ 94,623  | \$ 20,286 | 21.4%    |
| Management and franchise fees | 5,343                          | 5,143     | 200       | 3.9%     | 10,420                       | 10,351     | 69        | 0.7%     |
| Tenant reinsurance            | 3,980                          | 2,688     | 1,292     | 48.1%    | 7,458                        | 4,831      | 2,627     | 54.4%    |
| Other income                  | 128                            | 327       | (199)     | (60.9)%  | 256                          | 521        | (265)     | (50.9)%  |
| Total revenues                | \$ 67,336                      | \$ 56,550 | \$ 10,786 | 19.1%    | \$ 133,043                   | \$ 110,326 | \$ 22,717 | 20.6%    |

**Property Rental** The increase in property rental revenue for the three and six months ended June 30, 2008 consists of \$8,410 and \$17,664, respectively, associated with acquisitions completed during 2007 and 2008, \$629 and \$1,751, respectively from rental rate increases at stabilized properties, and \$454 and \$871 from increases in occupancy and rental rates at lease-up properties.

**Management and Franchise Fees** Management and franchise fees represent approximately 6% of gross revenues under management.

**Tenant Reinsurance** The increase in tenant reinsurance revenues is due to our continued success in promoting the tenant reinsurance program at our sites during the first two quarters of 2008. Overall customer participation increased to approximately 43% at June 30, 2008 compared to approximately 29% at June 30, 2007.

## Expenses

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

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|                                               | Three Months Ended<br>June 30, |           |           |          | Six Months Ended<br>June 30, |           |           |          |
|-----------------------------------------------|--------------------------------|-----------|-----------|----------|------------------------------|-----------|-----------|----------|
|                                               | 2008                           | 2007      | \$ Change | % Change | 2008                         | 2007      | \$ Change | % Change |
| <b>Expenses:</b>                              |                                |           |           |          |                              |           |           |          |
| Property operations                           | \$ 20,863                      | \$ 17,352 | \$ 3,511  | 20.2%    | \$ 41,504                    | \$ 34,248 | \$ 7,256  | 21.2%    |
| Tenant reinsurance                            | 1,370                          | 1,217     | 153       | 12.6%    | 2,532                        | 2,190     | 342       | 15.6%    |
| Unrecovered development and acquisition costs | 1,428                          | 159       | 1,269     | 798.1%   | 1,592                        | 409       | 1,183     | 289.2%   |
| General and administrative                    | 10,070                         | 8,968     | 1,102     | 12.3%    | 20,249                       | 18,208    | 2,041     | 11.2%    |
| Depreciation and amortization                 | 11,697                         | 9,123     | 2,574     | 28.2%    | 23,278                       | 17,919    | 5,359     | 29.9%    |
| Total expenses                                | \$ 45,428                      | \$ 36,819 | \$ 8,609  | 23.4%    | \$ 89,155                    | \$ 72,974 | \$ 16,181 | 22.2%    |

**Property Operations** The increase in property operations expense during the three and six months ended June 30, 2008 was due to increases of \$3,080 and \$6,322, respectively, associated with acquisitions of new properties during 2007 and 2008, and \$431 and \$934, respectively, at existing stabilized and lease-up properties due to increases in snow removal and property insurance.

**Tenant Reinsurance** The increase in tenant reinsurance expense is due to our continued success in promoting the tenant reinsurance program at our sites during the first two quarters of 2008. Overall customer participation increased to approximately 43% at June 30, 2008 compared to approximately 29% at June 30, 2007.

**Unrecovered Development/Acquisition Costs** These costs relate to unsuccessful development and acquisition activities during the periods indicated. The increase for the three and six months ended June 30, 2008 is primarily due to the write-off of costs related to an unsuccessful acquisition.

**General and Administrative** The increase in general and administrative expenses was primarily due to the increased costs associated with the management of the additional properties that were added through acquisitions and development in 2007 and 2008.

**Depreciation and Amortization** The increase in depreciation and amortization expense is a result of additional properties that were added through acquisitions and development in 2007 and 2008.

Table of Contents**Other Revenues and Expenses**

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

|                                                               | Three Months Ended<br>June 30, |             |    |         |          | Six Months Ended<br>June 30, |             |    |         |          |
|---------------------------------------------------------------|--------------------------------|-------------|----|---------|----------|------------------------------|-------------|----|---------|----------|
|                                                               | 2008                           | 2007        | \$ | Change  | % Change | 2008                         | 2007        | \$ | Change  | % Change |
| <b>Other revenue and expenses:</b>                            |                                |             |    |         |          |                              |             |    |         |          |
| Interest expense                                              | \$ (15,962)                    | \$ (15,437) | \$ | (525)   | 3.4%     | \$ (32,316)                  | \$ (28,833) | \$ | (3,483) | 12.1%    |
| Interest income                                               | 870                            | 3,668       |    | (2,798) | (76.3)%  | 1,295                        | 5,116       |    | (3,821) | (74.7)%  |
| Interest income on note receivable from Preferred Unit holder | 1,212                          |             |    | 1,212   | 100.0%   | 2,425                        |             |    | 2,425   | 100.0%   |
| Equity in earnings of real estate ventures                    | 1,373                          | 1,192       |    | 181     | 15.2%    | 2,595                        | 2,389       |    | 206     | 8.6%     |
| Loss on sale of investments available for sale                |                                |             |    |         |          | (1,415)                      |             |    | (1,415) | (100.0)% |
| Minority interest - Operating Partnership                     | (617)                          | (515)       |    | (102)   | 19.8%    | (1,127)                      | (899)       |    | (228)   | 25.4%    |
| Minority interest - other                                     | 117                            | 56          |    | 61      | 108.9%   | 256                          | 40          |    | 216     | 540.0%   |
| Total other expense                                           | \$ (13,007)                    | \$ (11,036) | \$ | (1,971) | 17.9%    | \$ (28,287)                  | \$ (22,187) | \$ | (6,100) | 27.5%    |

**Interest Expense** The increase in interest expense for the three months ended June 30, 2008 consists mainly of \$1,094 associated with new loans obtained on properties acquired in 2007 and 2008, offset by a decrease of \$454 on corporate and other debt as a result of an increase in capitalized interest. The increase in interest expense for the six months ended June 30, 2008 consists primarily of \$2,496 associated with new loans obtained on properties acquired in 2007 and 2008 and an increase of approximately \$2,280 related to the \$250,000 in exchangeable senior notes issued in March 2007.

**Interest Income** The decrease in interest income was due primarily to the fact that we held more than \$90,000 of investments available for sale at June 30, 2007 versus having no investments available for sale at June 30, 2008. The investments available for sale were purchased with cash that was generated by the exchangeable senior notes offering in March 2007. This was partially offset by the additional interest generated from the proceeds of the common stock offering in May 2008 held in cash and cash equivalents.

**Interest Income on Note Receivable from Preferred Unit Holder** Represents interest on a \$100,000 loan to the holders of the Preferred OP units.

**Equity in Earnings of Real Estate Ventures** The increase in equity in earnings of real estate ventures for the three and six months ended June 30, 2008 is primarily due to increases in property net income from stabilized joint venture properties offset by losses from lease up properties in certain joint ventures.

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**Loss on Sale of Investments Available for Sale** Represents the amount of loss recorded on February 29, 2008 related to the liquidation of auction rates securities held in investments available for sale.

**Minority Interest Operating Partnership** Income allocated to the Operating Partnership (including the Preferred OP units) represents 5.84% and 5.59% of the net income before minority interest for the three months ended June 30, 2008 and 2007, respectively.

**Minority Interest Other** Income allocated to the other minority interest represents the losses allocated to partners in consolidated joint ventures on two properties that are in lease-up.

### 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 because net earnings assumes that the values of real estate assets diminish predictably over time as reflected through depreciation and amortization expenses. We believe that the values of real estate assets fluctuate due to market conditions and 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 the 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 (amounts are in thousands, except for share data):

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|                                                             | Three months ended June 30, |            | Six months ended June 30, |            |
|-------------------------------------------------------------|-----------------------------|------------|---------------------------|------------|
|                                                             | 2008                        | 2007       | 2008                      | 2007       |
| <b>Net income</b>                                           | \$ 8,901                    | \$ 8,695   | \$ 15,601                 | \$ 15,165  |
| Adjustments:                                                |                             |            |                           |            |
| Real estate depreciation                                    | 9,975                       | 7,831      | 19,735                    | 15,416     |
| Amortization of intangibles                                 | 1,159                       | 807        | 2,437                     | 1,614      |
| Joint venture real estate depreciation and amortization     | 1,058                       | 1,025      | 2,110                     | 2,087      |
| Joint venture loss on sale of properties                    |                             | 5          |                           | 5          |
| Distributions paid on Preferred Operating Partnership units | (1,437)                     |            | (2,875)                   |            |
| Income allocated to Operating Partnership minority interest | 617                         | 515        | 1,127                     | 899        |
| <b>Funds from operations</b>                                | \$ 20,273                   | \$ 18,878  | \$ 38,135                 | \$ 35,186  |
| <b>Weighted average number of shares - diluted</b>          | 79,092,783                  | 69,248,845 | 75,166,645                | 69,214,313 |

## 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.

|                                                    | Three months ended June 30, |           | Percent | Six months ended June 30, |           | Percent |
|----------------------------------------------------|-----------------------------|-----------|---------|---------------------------|-----------|---------|
|                                                    | 2008                        | 2007      | Change  | 2008                      | 2007      | Change  |
| Same-store rental revenues                         | \$ 46,277                   | \$ 45,648 | 1.4%    | \$ 92,081                 | \$ 90,330 | 1.9%    |
| Same-store operating expenses                      | 15,946                      | 16,055    | -0.7%   | 32,272                    | 31,954    | 1.0%    |
| Same-store net operating income                    | 30,331                      | 29,593    | 2.5%    | 59,809                    | 58,376    | 2.5%    |
| Non same-store rental revenues                     | 11,608                      | 2,744     | 323.0%  | 22,828                    | 4,293     | 431.7%  |
| Non same-store operating expenses                  | 4,917                       | 1,297     | 279.1%  | 9,232                     | 2,294     | 302.4%  |
| Total rental revenues                              | 57,885                      | 48,392    | 19.6%   | 114,909                   | 94,623    | 21.4%   |
| Total operating expenses                           | 20,863                      | 17,352    | 20.2%   | 41,504                    | 34,248    | 21.2%   |
| Same-store square foot occupancy as of quarter end | 87.5%                       | 87.6%     |         | 87.5%                     | 87.6%     |         |
| Properties included in same-store                  | 211                         | 211       |         | 211                       | 211       |         |

The increase in same-store rental revenue for the three and six months ended June 30, 2008 over the prior year was due to increased rental rates to existing customers and our ability to maintain occupancy. For the three months ended June 30, 2008, expenses decreased when compared to the prior year due to lower advertising and payroll costs. For the six months ended June 30, 2008, expenses increased due to higher snow removal costs and insurance, partially offset by lower payroll costs.

## CASH FLOWS

Cash flows provided by operating activities were \$48,527 and \$51,905, respectively, for the six months ended June 30, 2008 and 2007. The decrease compared to the prior year primarily relates to the increase in receivables from related parties offset by the increase in depreciation and amortization and the loss on investments available for sale.

Cash used in investing activities was \$51,035 and \$205,629, respectively, for the six months ended June 30, 2008 and 2007. The decrease relates primarily to the change in investments available for sale. For the six months ended June 30, 2008, there were proceeds from the sale of investments available for sale of \$21,812 and for the six months ended June 30, 2007, there were payments for the purchase of investments available for sale of \$90,331.

Cash provided by financing activities was \$170,968 and \$128,713, respectively, for the six months ended June 30, 2008 and 2007. The increase in cash provided by financing activities over the prior period relates primarily to the proceeds from the sale of common stock in May 2008 of \$232,718. In March 2007, we issued \$250,000 in exchangeable senior notes and in June 2007, issued a \$100,000 loan to a preferred OP unit holder.

Table of Contents**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 properties, our CCSs and our Operating Partnership's CCUs will convert into additional shares of common stock and OP units, respectively.

As of June 30, 2008, 2,153,885 CCSs and 110,798 CCUs have converted to common stock and OP units, respectively. Based on the performance of the properties as of June 30, 2008, an additional 355,035 CCSs and 18,263 CCUs became eligible for conversion. The board of directors approved the conversion of these CCSs and CCUs on August 1, 2008 as per our charter, and the shares and units were issued on August 5, 2008.

The table below outlines the performance of the properties for the three and six months ended June 30, 2008 and 2007:

|                                                 | <b>Three Months Ended June 30,</b> |             | <b>Percent</b> | <b>Six Months Ended June 30,</b> |             | <b>Percent</b> |
|-------------------------------------------------|------------------------------------|-------------|----------------|----------------------------------|-------------|----------------|
|                                                 | <b>2008</b>                        | <b>2007</b> | <b>Change</b>  | <b>2008</b>                      | <b>2007</b> | <b>Change</b>  |
| CCS/CCU rental revenues                         | \$ 3,289                           | \$ 2,967    | 10.9%          | \$ 6,578                         | \$ 5,853    | 12.4%          |
| CCS/CCU operating expenses                      | 1,250                              | 1,333       | (6.2)%         | 2,590                            | 2,631       | (1.6)%         |
| CCS/CCU net operating income                    | 2,039                              | 1,634       | 24.8%          | 3,988                            | 3,222       | 23.8%          |
| Non CCS/CCU rental revenues                     | 54,596                             | 45,425      | 20.2%          | 108,331                          | 88,770      | 22.0%          |
| Non CCS/CCU operating expenses                  | 19,613                             | 16,019      | 22.4%          | 38,914                           | 31,617      | 23.1%          |
| Total rental revenues                           | 57,885                             | 48,392      | 19.6%          | 114,909                          | 94,623      | 21.4%          |
| Total operating expenses                        | 20,863                             | 17,352      | 20.2%          | 41,504                           | 34,248      | 21.2%          |
| CCS/CCU square foot occupancy as of quarter end | 78.9%                              | 77.1%       |                | 78.9%                            | 77.1%       |                |
| Properties included in CCS/CCU                  | 14                                 | 14          |                | 14                               | 14          |                |

The increase in CCS/CCU rental revenues for the three and six months ended June 30, 2008 was primarily due to increased rental rates and increased occupancy. The decrease in expenses for the three and six months ended June 30, 2008 was primarily due to a reduction in advertising costs.

**OPERATIONAL SUMMARY**

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For the six months ended June 30, 2008, we continued our same-store property revenue growth with a revenue increase of 1.9% compared to the same period in 2007. Occupancy at our stabilized properties was fairly consistent on a year-to-year basis, reaching 86.9% as of June 30, 2008 compared to 86.4% as of June 30, 2007.

For the six months ended June 30, 2008, the markets of Chicago, Columbus, Detroit, Houston, Sacramento and San Francisco/Oakland were the top performers among our stabilized properties. Markets performing below our portfolio average in revenue growth included Las Vegas, Miami, Philadelphia, Phoenix and West Palm Beach.

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 snow removal and property insurance partially offset by decreases in payroll costs.

### OUTLOOK

In the first six months of 2008, we continued to see a generally positive climate for self-storage in the United States. Rental activity was flat overall when compared with the first six months of 2007. Despite the lack of increased demand, we were able to raise same-store and overall portfolio revenue through increased rental rates to existing customers. We continue to 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.

We anticipate generally positive self-storage fundamentals to continue in our core markets. We believe that the ability exists to

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increase revenues in 2008 over levels achieved in 2007. 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 2008.

We are continually seeking 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, including national cable television advertising, continue to be implemented. These activities also provide support for increased rentals at the store level.

Property taxes are seen as a primary driver of expenses in the coming year. As we continue to acquire existing self-storage facilities, tax reassessments will continue to occur.

**LIQUIDITY AND CAPITAL RESOURCES**

As of June 30, 2008, we had \$185,837 available in cash and cash equivalents. This cash resulted primarily from the issuance and sale of approximately 15.0 million shares of our common stock pursuant to a public offering in May 2008. We intend to use this cash to purchase additional self-storage properties and fund other working capital needs during the remainder of 2008. 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.

On October 19, 2007, we entered into a \$100,000 revolving line of credit (the Credit Line). We intend to use the proceeds from 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 of our financial ratios. The Credit Line is collateralized by mortgages on certain real estate assets. The Credit Line matures October 31, 2010. There were no amounts outstanding under the Credit Line as of June 30, 2008 or December 31, 2007.

As of June 30, 2008, we had \$1,300,671 of debt, resulting in a debt to total capitalization ratio of 49.3%. As of June 30, 2008, the ratio of total fixed rate debt and other instruments to total debt was 91.5% (\$61,770 on which we have a reverse interest rate swap has been included as variable rate debt). The weighted average interest rate of the total of fixed and variable rate debt at June 30, 2008 was 4.9%.

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 June 30, 2008.

We expect to fund our short-term liquidity requirements, including operating expenses, recurring capital expenditures, dividends to stockholders, distributions to holders of OP units and interest on our outstanding indebtedness out of our operating cash flow, cash on hand and borrowings under the Credit Line.

Our liquidity needs also consist of new facility development, property acquisitions, principal payments under our borrowings and non-recurring capital expenditures. In addition, we evaluate, on an ongoing basis, the merits of strategic acquisitions and other relationships, which may require us to raise additional funds. We do not expect that our operating cash flow will be sufficient to fund our liquidity needs and instead expect to fund such needs out of additional borrowings of secured or unsecured indebtedness, joint ventures with third parties and from the proceeds of public and private offerings of equity and debt. Additional capital may not be available on terms favorable to us, or at all. Any additional issuance of equity or equity linked securities may result in dilution to our stockholders. In addition, any new securities we issue could have rights, preferences and privileges senior to holders of our common stock. We may also use OP units as currency to fund acquisitions from self-storage owners who desire tax-deferral in their exiting transactions.

## **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, we will consider factors including but not limited to:

- the interest rate of the proposed financing;
- the extent to which the financing impacts flexibility in managing our properties;
- prepayment penalties and restrictions on refinancing;
- the purchase price of properties acquired with debt financing;

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- long-term objectives with respect to the financing;
- target investment returns;
- the ability of particular properties, and our Company as a whole, to generate cash flow sufficient to cover expected debt service payments;
- overall level of consolidated indebtedness;
- timing of debt and lease maturities;
- provisions that require recourse and cross-collateralization;
- corporate credit ratios including debt service coverage, debt to total capitalization and debt to undepreciated assets; and
- the overall ratio of fixed and variable rate debt.

Our indebtedness may be recourse, non-recourse or cross-collateralized. If the indebtedness is non-recourse, the collateral will be limited to the particular properties to which the indebtedness relates. In addition, we may invest in properties subject to existing loans collateralized by mortgages or similar liens on our properties, or 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.

We may from time to time seek to retire or repurchase our outstanding debt in open market purchases, privately negotiated transactions or otherwise. Such repurchases, if any, will depend on prevailing market conditions, our liquidity requirements, contractual restrictions and other factors.

**OFF-BALANCE SHEET ARRANGEMENTS**

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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 as entities often referred to as structured finance or special purposes entities, which typically are established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. Further, except as disclosed in the notes to our 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.

The exchangeable senior notes provide for excess exchange value to be paid in 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 senior exchangeable notes.

### CONTRACTUAL OBLIGATIONS

The following table summarizes our contractual obligations as of June 30, 2008:

|                                                                         | Total        | Payments due by Period: |            |            |                  |
|-------------------------------------------------------------------------|--------------|-------------------------|------------|------------|------------------|
|                                                                         |              | Less Than<br>1 Year     | 1-3 Years  | 4-5 Years  | After<br>5 Years |
| Operating leases                                                        | \$ 62,466    | \$ 5,278                | \$ 9,853   | \$ 8,666   | \$ 38,669        |
| Notes payable, exchangeable senior<br>notes and notes payable to trusts |              |                         |            |            |                  |
| Interest                                                                | 598,547      | 57,903                  | 96,397     | 81,705     | 362,542          |
| Principal                                                               | 1,300,671    | 167,371                 | 342,861    | 20,855     | 769,584          |
| Total contractual obligations                                           | \$ 1,961,684 | \$ 230,552              | \$ 449,111 | \$ 111,226 | \$ 1,170,795     |

At June 30, 2008, the weighted-average interest rate for all fixed rate loans was 5.0%, and the weighted-average interest rate for all variable rate loans was 3.6%.

### SEASONALITY

The self-storage business is subject to seasonal fluctuations. A greater portion of revenues and profits are realized from May through

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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.

As of June 30, 2008, we had \$1,300,671 in total debt, of which \$110,609 was subject to variable interest rates (including the \$61,770 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 \$1,106 annually.

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

The fair value of fixed rate notes payable, exchangeable senior notes and notes payable to trusts at June 30, 2008 was \$1,256,317. The carrying value of these fixed rate notes payable, exchangeable senior notes and notes payable to trusts at June 30, 2008 was \$1,190,062.

**ITEM 4. CONTROLS AND PROCEDURES**

**(i) Disclosure Controls and Procedures**

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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 formed a disclosure committee to ensure that all disclosures made by the Company to its security holders or to 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

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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 our 2007 Annual Report on Form 10-K.

**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 properties, our CCSs and our CCUs will convert into additional shares of common stock and OP 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 June 30, 2008, 2,153,885 CCSs and 110,798 CCUs had converted to common stock and OP units, respectively. Based on the performance of the properties as of June 30, 2008, an additional 355,035 CCSs and 18,263 CCUs became eligible for conversion. The board of directors approved the conversion of these CCSs and CCUs on August 1, 2008 as per our charter, and the shares and units were issued on August 5, 2008. 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.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

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

We held our annual meeting of stockholders on May 21, 2008. The first item of business was the election of seven members of the board of directors. The votes were tabulated as follows: 45,699,856 votes were cast for Kenneth M. Woolley and 1,153,102 votes were withheld; 46,278,530 votes were cast for Anthony Fanticola and 574,428 votes were withheld; 46,530,390 votes were cast for Hugh W. Horne and 322,568 votes were withheld; 46,532,895 votes were cast for Spencer F. Kirk and 320,063 votes were withheld; 46,513,403 votes were cast for Joseph D. Margolis and 339,555 votes were withheld; 45,198,417 votes were cast for Roger B. Porter and 1,654,541 votes were withheld; and 46,276,310 votes were cast for K. Fred Skousen and 576,648 votes were withheld. The second item of business was a proposal for the approval of the 2004 Long Term Incentive Compensation Plan as Amended and Restated, Effective March 25, 2008. The votes were tabulated as follows: 40,435,203 were cast for, 1,984,694 were cast against, 66,652, abstained, and there were 4,366,409 broker non-votes. The third item of business was a proposal to ratify the selection of Ernst & Young LLP as our independent registered public accounting firm for the year ending December 31, 2008. The votes were tabulated as follows: 46,684,140 were cast for, 128,183 were cast against, and 40,635 abstained.

**ITEM 5. OTHER INFORMATION**

None.

**ITEM 6. EXHIBITS**

31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1\* Certifications of the Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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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.

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**SIGNATURES**

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

EXTRA SPACE STORAGE INC.  
*Registrant*

Date: August 8, 2008

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

Date: August 8, 2008

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